Market Review and Outlook—March 10, 2007

In life and in investing I'm a **contrarian**—I like good values, and I like it when odds are in my favor, regardless of what crowds are saying. Due to my nature, I am largely unphased when markets stumble, as the stock markets have done in the past two weeks. If anything, as a result I am looking for opportunities to boost stock positions. Now a good contrarian doesn't simply buy when prices are falling; as I mentioned, they are also very concerned about odds—how likely is the investment likely to rise versus fall. When a stock falls for good reason (Enron, Worldcom, …), that is not a good enough reason to buy. However, when a stock or a stock market falls for more emotional than fundamental reasons, stand back for here I come.

Stock markets and economies do not travel on smooth paths. There are rises and falls, bumps, turbulence, and periods of unwarranted optimism, and unwarranted fear. Uncertainty is always present, and this is necessary. The **stock markets hit a bump in late February**, one that 'took some excesses' out of the market. I did not consider the markets overpriced beforehand (other than some overseas markets). The table below shows only two categories with oversized one-year returns—international stocks and real estate. Most investment markets appear to offer upside:downside profiles that warrant sticking to long-term targets, and possibly even boosting some undervalued stock areas.

I (still) favor large US stocks and carefully building up growth investments. More importantly, investors should focus on the big picture, the proper balance of stocks to bonds. The recent market drop provides a good opportunity to do a 'gut check' and see if you have too much in stocks, in which case you can gradually pare them back. With an appropriate level of stocks and bonds, I favor a 2:1 ratio of US:foreign stocks. For bonds, I continue to prefer to place 80% in high-quality bonds, and 'playing around' with the rest, both in high yield and in foreign bonds. This last area, foreign bonds, help the portfolio when the US dollar falls, as it did in 2006, and as it appears likely to continue to do.

It is hard to 'keep the faith' with bonds, due to their low yields and returns, especially given the 5% returns from money markets and CDs. I am comfortable shifting from bonds to money markets/CDs in this environment due to yields, but not shifting from bonds to stocks merely due to current yields. Bonds/cash serve to stabilize a portfolio during rocky times. In February as large US stocks fell 2%, bond funds rose 1 to 1.5%. Thanks, bonds!

The following data, reflecting results through 2/28/2007, comes from Morningstar's Principia Pro product.

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
Money Market—Taxable	+1.18%	+4.51%	+2.71%	+1.98%	+3.39%
Intermediate Term Bond	+1.02%	+5.29%	+3.27%	+4.67%	+5.62%
Intermediate Muni Bond	+0.41%	+3.80%	+2.45%	+3.88%	+4.62%
Large-Cap Core Stock	+1.22%	+10.71%	+8.90%	+6.67%	+7.22%
Mid-Cap Core	+3.52%	+11.90%	+12.28%	+11.61%	+11.12%
Small-Cap Core	+1.96%	+8.91%	+12.22%	+12.47%	+11.09%
International Stock	+3.94%	+18.52%	+17.71%	+14.25%	+7.37%
Real Estate	+4.99%	+29.93%	+24.72%	+23.71%	+15.01%
Natural Resources	-2.81%	+8.25%	+23.23%	+20.50%	+13.19%
Technology	-0.02%	+2.93%	+4.96%	+4.77%	+6.70%
Multi-Cap Growth	+1.66%	+5.09%	+8.40%	+7.22%	+7.61%
Multi-Cap Value	+2.53%	+13.10%	+12.29%	+11.45%	+10.49%
Conservative Allocation	+1.99%	+7.44%	+5.28%	+5.80%	+5.80%