

## Market Review and Outlook—December 13, 2007

**Well, it started out well!** Large US and foreign stocks did well in September and October, although smaller US stocks were fairly flat. Then November brought an early chill, as all stocks fell 5% or so. So far this month stocks are up and down, but little changed from 11/30. Year-to-date, large and mid-cap US stocks are up about 7%, small-caps are up only 2.5%, and foreign stocks are up over 14%.

**What a tangled web we weave!** The problems in stock markets are primarily due to ‘financial engineering’, the tricks that Wall Street played to create a new type of investment every day, for which Wall Street was well rewarded. These new tricks permitted the housing bubble to grow very large, for money was available to extend to borrowers who did not have the ability to pay. The money was available because investors were getting a good amount of interest from what they thought was a high quality investment, when, in fact, it was for a low quality investment. The reason that it wasn’t clear was that the ‘financial engineering’ was quite advanced.

**What’s next?** The fallout from this sham has been going on for more than six months, and it appears to have a lot further to go. It further appears that until it is fully resolved, the housing market will be unable to rebound. It is possible/likely that until housing prices rebound, consumers will be restrained in their spending, which will slow the US economy. The Fed seems likely to continue its efforts to slowly lower short-term rates to help soften the pain.

One big question is how contagious this is, whether foreign economies will also be subdued in 2008. If, instead, foreign economies (and stock markets) are largely unscathed, then the US dollar could continue to weaken (who wants to hold dollars when interest rates in the country are lower and the economy is softer than outside the US).

**What should an investor do?** By now you know the Mallard refrain—keep to your targets. However, I suggest caution overseas where gains have almost doubled gains from US stocks over the past three years. I favor keeping foreign stocks a little under target levels. A strong showing in 2007 has enabled growth to ‘catch up to’ value investing; I am neutral about them going forward. Small US stocks have been hit hard in 2007; while I may be early, I am in favor of boosting small US stocks above target levels at this time. Finally, I am comfortable slowly building up real estate investments (REIT funds), after a multi-year hiatus. I am very pleased with its past misfortune (down more than 10% so far this year), and am hopeful that this will translate into attractive future returns. Bonds continue to be bonds, boring. However they generally do a great job holding their value when stocks are falling, and they provide nice stability to portfolios that are paying out regular income.

*The following data, reflecting results through 11/30/2007, comes from the Wall Street Journal and Morningstar’s Advisor Workstation product.*

Category	3 Months	Past Year	3-Yr Avg	5-Yr Avg	10-Yr Avg
<b>Money Market—Taxable</b>	+1.15%	+4.70%	+3.06%	+2.14%	+3.38%
<b>Intermediate Term Bond</b>	+2.57%	+4.18%	+3.84%	+4.48%	+5.24%
<b>Intermediate Muni Bond</b>	+2.15%	+2.22%	+3.09%	+3.53%	+4.27%
<b>Large-Cap Blend Stock</b>	+1.55%	+8.08%	+10.16%	+11.57%	+6.18%
<b>Mid-Cap Blend</b>	-0.89%	+6.02%	+10.29%	+14.70%	+9.10%
<b>Small-Cap Blend</b>	-3.38%	-0.35%	+8.16%	+14.93%	+8.34%
<b>International Stock</b>	+6.23%	+18.36%	+19.52%	+19.89%	+8.17%
<b>Real Estate</b>	-2.98%	-10.13%	+11.39%	+19.32%	+11.31%
<b>Natural Resources</b>	+11.12%	+24.77%	+24.73%	+28.28%	+14.68%
<b>Technology</b>	+3.15%	+14.62%	+10.66%	+12.96%	+6.41%
<b>Multi-Cap Growth</b>	unavail	+14.65%	+11.99%	+13.62%	unavail
<b>Multi-Cap Value</b>	unavail	+3.20%	+9.51%	+12.90%	unavail
<b>Conservative Allocation</b>	+2.09%	+5.27%	+5.89%	+7.12%	+5.11%

*Information herein should not be construed by any consumer and/or prospective client as a solicitation to effect, or attempt to effect transactions in securities, or the rendering of personalized investment advice for compensation.*