

Market Review and Outlook—March 12, 2008

Are we in a recession or not? The stock markets have been falling for most of the year, as investors consider whether the US economy is shrinking, and if so, when it will begin to grow again. The Federal Reserve Bank (the Fed) sharply cut rates in January and has been continuing this path, to help the economy muddle along. Further, Congress and the White House crafted a ‘stimulation bill’, which puts money into the hands of Americans, largely those most likely to need it and to spend it quickly (on items such as food and shelter). I expect that these steps will bear fruit by the 2nd half of 2008, and that the US stock market will be well on a recovery path later this year (yesterday’s 3.7% jump could be a real start or a false one—it will take weeks to know).

What’s happened with the markets? The table below shows that stocks fell from 8 to over 10% in the past three months, with the weakest results occurring in technology, growth, and foreign stocks. I suspect that the foreign markets fell more in sympathy with US stock markets, than due to a concern about economic slowdown beyond our shores. As I have been preaching for a bit, foreign stocks have had such a strong run-up that they deserve to fall a bit, or even go sideways for awhile. The 10% decline in the past three months qualifies.

One interesting development is the 2% decline in the past three months in **municipal bonds**. This is partially due to the sub-prime fiasco, as firms that ‘insure’ municipal bonds were caught up with sub-prime, and their ability to back municipalities’ payments is in question. I am not too concerned, as Mallard’s clients’ municipal bond holdings are generally high quality without the ‘insurance’. I suspect that this is merely a **good opportunity** to pick up municipals yielding close to 4% in double-tax free income, with a chance of capital gains when investors shift to municipals in advance of next year’s likely rollback of the Republican tax cuts on investment income.

At this time, I recommend that clients build up their **US large and small-cap stocks** to target levels (or higher), and keep **US mid-cap and foreign stocks** a little lower than targets. I would like to continue to build up **real estate** investments, with a long-term target of about 5% of most portfolios, perhaps up to 2 or 3% at this time. **Energy/natural resource** funds have done too well to avoid concern over upcoming losses (what goes up ...). I would like to keep energy exposure in most portfolios at no more than target levels (12% or so of stocks).

Value stocks have been clobbered in the past year, due to the concentration of housing and financial companies in this arena. They will eventually come back, and should be brought up to normal levels at this time.

Bonds yield too little to get excited. Keep money in bonds and cash (money markets/CDs) for stability, and recognize a possible opportunity for municipals, however **the best returns for the next year or two should come from stocks**.

The following data, reflecting results through 2/29/2008 (except where otherwise noted),

| Category | 3 Months | Past Year | 3-Yr Avg | 5-Yr Avg | 10-Yr Avg |
|--|----------|-----------|----------|----------|-----------|
| Money Market—Taxable | +1.15% | +4.70% | +3.06% | +2.14% | +3.38% |
| Intermediate Term Bond | +1.13% | +4.37% | +3.89% | +3.91% | +5.17% |
| Intermediate Muni Bond | -2.15% | -0.37% | +1.95% | +2.45% | +3.81% |
| Large-Cap Blend Stock | -9.30% | -3.03% | +5.43% | +11.53% | +4.17% |
| Mid-Cap Blend | -8.35% | -6.19% | +5.98% | +14.91% | +7.45% |
| Small-Cap Blend | -9.52% | -11.55% | +3.92% | +14.96% | +6.74% |
| International Stock | -10.14% | +2.31% | +12.91% | +19.83% | +6.12% |
| Real Estate | -9.72% | -22.77% | +7.87% | +16.81% | +10.07% |
| Natural Resources | +5.72% | +36.29% | +22.74% | +28.59% | +15.51% |
| Technology | -15.31% | -2.80% | +5.57% | +12.45% | +3.52% |
| Multi-Cap Growth (only through 2/28/08) | -8.86% | +3.46% | +8.03% | +13.78% | +4.61% |
| Multi-Cap Value (only through 2/28/08) | -6.62% | -5.74% | +5.62% | +13.70% | +6.35% |
| Conservative Allocation | -2.74% | +1.11% | +4.30% | +6.46% | +4.30% |

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