

Thank God It's Friday!

August 3, 2007

Never borrow what you can't pay back. Pretty basic philosophy and sound logic. Unfortunately, not everyone follows those guidelines. We've discussed many times how the market rally of the last 12 months has been liquidity driven. Corporate profits have surged and created significant cash positions that needed to be deployed. That's part of it. There has also been significant leverage being used to fund investment purchases; common practice with hedge funds and private equity firms. With interest rates still at historically low rates, money has been cheap, so many have been borrowing in size and buying everything in sight. Margin positions have ballooned to highs not seen since the late 90's.

It's a winning strategy when the assets purchased continue to go higher, which has been the case for the last 4 years. But if the trend turns, look out. Pain is generally the result. Just look at the mortgage stocks for reference. Greed has crept back in and now comes some punishment. Unfortunately it's usually shoot first and ask questions later. That translates to a total market sell-off rather than just the select companies in question. There is a ripple effect to be sure, and with so much uncertainty, the weakness should continue.

The lenders have been among the greediest of parties involved, underwriting loans to basically anyone with a pulse. So the borrowers with spotty credit are now rolling over. A number of hedge funds have been wiped out already. Hedge fund investors are estimated to lose as much as \$125 Billion this year. It is estimated that 1.2 million mortgages will default this year. These numbers are not pretty.

There has been some panic selling in recent days. When emotions run high, logic tends to evaporate. The lights have been turned on and the roaches are scurrying, but the house remains in working order. The US economy is hitting some road bumps right now, and the Markets are re-pricing risk. Things will sort themselves out, that's what makes a market. The global economic environment remains strong. Both stocks and bonds have gone on sale, and we're putting together another shopping list. High quality investments are becoming cheap again. We're just looking for some firmer footing, and will pay cash up front. Despite the correction, the major indexes remain in positive territory for the year. We expect this volatility to continue this summer, and we've prepared for it.

By Mike Frazier

INDEX	08.03.2007	12.31.2006	%Change
DOW JONES	13,181	12,463	+5.8%
S&P 500	1433	1,418	+1.0%
NASDAQ	2511	2,415	+3.9%
Bond YIELD	4.70%	4.71%	-0.1%*