



Thank God It's Friday!

May 23, 2008

Volatility has been a major theme for the markets for nearly a year - this week was no different. Wide fluctuations that have moved the DOW 100+ points in both directions have been quite common in 2008. In fact, in the 100 trading days so far this year, 48 of them have had a triple digit move! Three of those days were this week.

Why so much volatility? The market is dealing with a laundry list of issues. At the top of the list is the price of oil. Surging crude has brought gas prices to near \$4. High energy costs create an additional tax on consumer spending. And the American consumer already has enough challenges to deal with. The big question is at what price is the breaking point? 5 years ago it was said that \$50 crude would cause a shock that would stall the global economy. That came and went. Next was \$80, then \$100. Crude oil has spiked 40% so far this year, touching an all-time high of \$135 on Tuesday. We are in uncharted waters which has heightened awareness and caused some anxiety. The debate is front and center in Washington and blame is being cast in every direction.

Many foreign governments subsidize the cost of energy, which makes it cheaper for its citizens; this is the case in China. On the flip side, Europeans place a heavy tax on the price of the commodity, which influences consumption and promotes conservation. The US is one of the few that allow the free market to dictate prices. Rising costs are indeed impacting American's driving behavior. Here in the Bay Area, both the Golden Gate and Bay Bridges have experienced a decline in traffic this spring while BART has absorbed the traffic flow.

This weekend marks the official beginning of the "Summer Driving Season", where historically gas prices begin their rise. In addition, Hurricane season is soon approaching, which threatens oil production along the Gulf Coast. All of this will undoubtedly impact the price of crude, with a bias to more upside.

The supply/demand balance for energy remains extremely tight. China and India's growth keeps slurping up oil, as does the US lifestyle. Oil companies are feverishly trying to bring on new supplies to meet demand at these elevated prices, but the cycle is time and capital intensive. Many are calling out speculative investors as the culprit of artificially driving the price of oil and gas higher. Logic tells us it's a combination of all and the only real answer is conservation. Reduced demand is the only sure fire way to reduce prices.

Fortunately, the US economy is much less dependent on oil today than 30 years ago. We have technology to thank for that. Other areas in the global economy are working and should continue. But make no mistake, the cost of energy still matters. Oil at current and higher levels will hold back consumers, which will put a lid on this stock market and contribute to volatility. We mentioned in our January newsletter that even though we don't expect a recession, we would invest as if there was one. This strategy still applies.

INDEX	05.23.2008	12.31.2007	%Change
DOW JONES	12,479	13,265	-5.9%
S&P 500	1,375	1,468	-6.3%
NASDAQ	2,444	2,652	-7.80%
Bond YIELD	3.83%	4.03%	-4.9%*

Bond Prices ↓ Bond Yield % ↑

As a reminder the markets are closed Monday as is our office. Happy Memorial Day!

By Mike Frazier