Weinstat & Weinstat Investment Advisors & CPA's
516-621-3507 | info@weinstatandweinstat.com

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Greetings,

The stock market is a mess. The last quarter was the worst for the stock market since the fourth quarter of 2002. That quarter marked the lowest point of the worst bear market since the great depression. The economy is in bad shape, mostly as a result of the sub prime debacle and the worst housing market since the 1930's. High energy and food prices haven't exactly helped the matter. Even though I have a long term perspective, it is quite upsetting to be doing this poorly, even over a very short period of time. It is a small consolation that we have made up some major ground subsequent to March 31. Other than commodities and commodity related stocks, there is nowhere to hide.

If the economy were to be compared to the weather, then the stock market is seeing a hurricane comparable to Katrina. Hurricane Katrina destroyed most of New Orleans two and one half years ago. I see the economy at this point in time as a violent thunderstorm. There is occasionally some damage. The storm eventually passes and then things clear up.

Much of what is happening in the stock market is in essence a giant margin call. Hedge funds control ten times more money now than they did 7-8 years ago. That in itself is not a terrible thing. It is the way they make their money that can result in calamity for the financial system. When our mutual funds receive say $ 100 million in assets from their customers, they put the money to work by purchasing close to $ 100 million in stocks. When most hedge funds receive $ 100 million from their customers, they borrow anywhere from $ 500 million to $ 2 billion. They just don't purchase stocks. They also buy commodities contracts, bonds; mortgage backed securities, real estate as well as shorting various financial instruments. If they guess correctly, they produce outsized returns which are what their investors expect, partly because they receive outsized fees. If they guess wrong, they lose much of their investor's assets, sometimes all of their assets. These are the results of having too much leverage in the financial system. This affects us in that when the assets that are pledged against the debt go down, the lenders require more assets to be put up as collateral. Since the hedge funds don't have any additional assets to pledge, they must sell what they have to satisfy their lenders. Since much of their assets are not liquid (not quickly converted to cash), they are selling quickly what they can and what is most easily sold are the stocks that we and our mutual funds own.

What never ceases to amaze me is that consistently over the last 15 years the vast majority of people project that whatever is happening now will continue as it is for the foreseeable future. During the tech. bubble (from late 1998 to early 2000), I refused to invest in internet stocks or high flying mutual funds. To fully disclose, I did purchase a couple of high priced tech. stocks for myself and my clients which amounted to less than 10% of my portfolio. 1999 was also the last time that I underperformed the market by more than a minimal amount. What I told numerous people (including several clients at

One Expressway Plaza, Suite 112 | Roslyn Heights, NY 11577

the time) was that this mania could not possibly last much longer. I was told that I was out of touch, a dinosaur and other names that I can not print. The tech. bubble helped cause the worst bear market since the great depression. In late 2002 and early 2003, I was stating that the bear market won't last forever and that there were some incredible buying opportunities. Other than myself and a few other people I knew (which included a couple smart mutual fund managers I still have), virtually nobody wanted to buy anything, regardless of how cheap many stocks were. People want to buy stocks when they feel good. They feel good when the price of stocks are high. People feel miserable when stock prices are low. You make money purchasing stocks when you are the most miserable. When I was miserable in late 2002 and 2003, I put my money where my mouth was and purchased a handful of blue chip stocks, most of which I have sold at nice profits. At the time, I was called overly optimistic and just plain dumb. People couldn't understand how I could buy stocks in such a lousy market. In 2003- the S&P 500 returned 28.7%. My clients made between 30-40%.

When I talk to people now and state that the market will eventually turn around, I am not called any names or insulted. The vast majority of people still disagree with me. Most people feel that things will go on the way they are now for a long time, just like in 1999 and 2002.

A recent column in Barron's pointed out that the Investors intelligence survey is registering five year highs in bearishness among newsletter advisers, as are individual investor polls. Investor attitudes have rushed to extreme levels of anxiety last seen in 2003-2003, when the market was cut in half over three years. Merrill Lynch's monthly fund-manager survey shows the greatest number of asset allocaters saying they're the most overweight cash in the survey's 10 year history. Birinyi associates blogger sentiment poll last week showed 52% bears. Historically, when we are at a time of extreme pessimism is when things turn around. If you have a time frame longer than 3 months, it is a good time to be invested in stocks and put new money to work.

Without a doubt, the economy is in bad shape. This is mostly due to the sub prime debacle and the horrible housing market. I have to admit, I was wrong about the sub prime mess. I did see the warning signs and I knew that it would be bad. I didn't think that it would be this bad or last for this long. The reason I didn't think it would be this bad was because I severely overestimated the level of intelligence of the people running the large financial institutions as well as underestimating their level of greed. I now know that there is no limit to their level of greed. The economy could possibly be in a recession. I don't know for sure. Even if we are not in a recession, it will feel like we are in one for at least the next three months, most likely longer if energy and food prices keep rising like they are now. My gut feeling is that the current quarter will not be as bad as the quarter that just passed. I should also point out that stock prices generally move up prior to an economy recovery.

I have done a great deal of thinking about this "bad economy" that we are in now. While trying not to get philosophical, bad is a relative description. I just think that most people don't really know what a truly bad, awful economy really is. Many who do know may not remember. I grew up in the 1970's. Back then, unemployment, inflation and interest rates were all over 10%. I don't think things now are nearly as bad as they were then. My Dad grew up in the 1930's. Back then, unemployment ranged between 25-33%. There was no inflation since no one had any money to buy anything. I think things are not as bad now as they were then. Yes, the economy is worse now than it was during most of the 1990's. That was an exceptional time and I don't think that things will be as good as they were then for awhile if ever. I do think that once the economy shows some improvement, it will be comparable to what it was during most of the 1980's and most of the 1980's wasn't so bad.

Bear Stearns was in business for 85 years. They survived the Great Depression of the 1930's and the savings and loan crises of the late 1980's. They couldn't survive this credit crises. They were the victim of a good old fashion bank run. They didn't have a George Bailey (the character Jimmy Stewart played in It's a Wonderful Life) to save them with his honeymoon money as he saved the Bailey building and loan. Jaime Diamon (the CEO of JPMorganchase) did do a nice imitation of the Mr. Potter character. Recently I watched CNN do a piece of irresponsible journalism when they did a small story about what they called the Bear Stearns bail out. I want to make this as clear as possible; the United States government did not bail out Bear Stearns. They may have bailed out Wall Street but they did not bail out Bear Stearns since there is no more Bear Stearns. The vast majority of their 14,000 employees are out of work. Most of them have lost the vast majority of their life savings since Bear Stearns was 30% owned by their employees. What the Federal Reserve did with the explicit approval of the Treasury Department was orchestrate a forced fire sale of Bear Stearns while at the same time, hand the company over to JPMorganchase for the bankruptcy price of $2 per share. If this were a bail out like some uninformed people are stating, then the government would have guaranteed Bear Stearns debt and kept them around as a going concern, found some way to keep the shareholders whole during a forced liquidation or extended them credit while they sought a buyer at a higher price. This was not the case. What the Federal Reserve did do was guarantee that JPMorganchase could not lose anything on the deal by guaranteeing $ 30 billion of the debt that they assumed as part of the fire sale. The building that Bear Stearns owns is worth at least $ 10 per share in a bad real estate market. Barron's did a story on Bear Stearns the day before this happened estimating the liquidation value of Bear Stearns to be at least $30 per share. Several days after this was announced, Jamie Diamon announced that he increased the offer to $10 a share and assumed $ 1 billion of the debt leaving the government (us- the government gets their money from us and everyone that you know) on the hook for only $ 29 billion if the deal doesn't work out. Mr. Diamon isn't that generous. He is shrewd and said that he wanted to avoid a shareholder revolt (which was in the works) and as much future litigation as possible. Normally, this deal would have needed shareholder approval but since Bear Stearns's board of directors issued an additional 39% of shares of stock to JPM, they voted in favor of the deal with their new shares and Bear Stearns was put to rest. The Bush administration said they approved the deal for the greater good of the overall market and to avoid further disruption of the credit markets. So much for the so called "free market". The only thing that is free is what JPM acquired Bear Stearns for. Keep in mind that Bear Stearns stock price was $150 a share a little more than a year ago and $60 per share a week before the fire sale.

I have very little to say about our mutual funds. They are all doing equally bad and none of them are standing out either on the positive or negative side. I will go into more details about them as the year progresses. I will state that as the stock market behaves more rationally, then their performance will improve significantly.

If you have anything that you want to discuss or if you have any questions, please by all means either give me a call or send me an email

Sincerely,

Michael Weinstat, RIA, CPA