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INVESTMENT ADVISORS & CPA'S

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Greetings,

Happy New Year. Enclosed is your investment report for 2007. It was easily the most bizarre year for the stock market since the height of the tech. bubble in 1999. When I think about how well we were doing just a few months ago, then without a doubt it is a major disappointment that we didn't finish up strong and have a great year, which is my objective. However, we don't live in a vacuum. With all the obsession on the possibility of a recession, the sub prime mess, record foreclosures, the worst housing market possibly in fifty years, plus record high energy prices, it is difficult to expect to do much better than we did. If I feel it is necessary, then I will continue to make more moves this year.

The chatter among the talking heads continues to be the sub prime mess along with the deteriorating housing market. Without a doubt, with the exception of Goldman Sachs, the banks and brokers are a disaster. Merrill Lynch, at least IMO, is the leader of the pack as far as being a mess because they created many of these securities which are backed up by many of these sub prime loans. They packaged them as products to be sold to the market and collected millions of dollars of fees on the sales. After helping to create the Enron fraud in the late 1990's, you would think that they would have learned their lesson. They have written off close to ten billion dollars (they kept many of these securities for themselves as investments) of their shareholders' money in addition to losing who knows how many billions of dollars of their customers' money. Their CEO has lost his job and they just had to raise six billion dollars from a foreign investor at a 12% discount to their stock price to shore up their capital base. Numerous other financial institutions (UBS, Citigroup, Morgan Stanley, Washington Mutual to name a few) have had to issue preferred stock (which dilute their earnings) at high dividend rates, reduce their dividends on the common stock and eliminate their stock buy back programs. As usual, the shareholders are left holding the bag.

The million dollar question will be whether the credit crunch and the housing market lead to a recession. Joe Kernan of CNBC (whom I enjoy listening to) said that if there is a recession, it will be the most widely predicted recession ever. The economists who attempt to predict such things are notoriously wrong. They remind me of the weatherman, stock analysts and horse racing touts in that they do a great job of explaining why they were wrong after the fact. Nine months ago, if you would have asked me if there would be recession, I would have said that the chances are remote. At this point in time, I think there is a possibility that there will be a short, mild recession. I think it is more likely that the economy will suffer a major slowdown while avoiding a recession. There is a big difference between a slowdown and a recession.

What I do is ignore the chatter and focus on the data. Unemployment is still at a historically low rate of 5.0%. Over the last ten years, the average unemployment rate is 5.2% and 6.0% over the last twenty years. While occasionally talking to a naysayer about why the economy will avoid a recession, I ask when was the last time the economy fell into a recession with such a low unemployment rate? The answer is never. Just over 2/3 of the economy (the GDP that is) is consumer spending. As long as unemployment is not a problem, the consumer will continue to spend into oblivion. Believe me; the consumer is not doing well. Consumer debt is at record levels both in absolute terms and relative to income. The high energy prices are a big concern to me. Considering that during the housing boom, the home owners were using the equity in their houses like ATM machines, I am pleasantly surprised that the consumer has been so resilient. The housing market has been bad for a year and a half and energy prices have been high for the past year. I figure that if the consumer hasn't collapsed despite all the adversity this year, then consumer spending should slowdown but not fall off a cliff. The problem is that although the economy most likely will not go into a recession, it will feel like a recession for at least the next 6 months.

The Federal Reserve has continued to lower short term interest rates but not at a fast enough pace to satisfy the short sighted people on Wall Street. The problem is as mentioned in the previous investment report, is that the lower short term interest rates aren't helping the people who need it the most. Long term rates matter the most and they are already low.

Last quarter corporate profits were horrible. They were horrible because of the billions of dollars lost in the financial sector. Outside the financial sector, corporate profits were pretty good.

If you have any questions or have anything to discuss, please by all means give me a call or send me an email. I really would like to hear from you. Please, just don't ask me what the market will do over a very short period of time. If I knew, I would be more than happy to tell you.

Sincerely,

Michael Weinstat, RIA, CPA