

## WHERE THE RUBBER MEETS THE ROAD

October 6, 2008

I know...the silence has been deafening. For the last year and a half, I have been writing about Moral Hazard and the de-leveraging of society; so this crisis really represents nothing new. In reality, de-leveraging continues and now every Tom, Dick and Harry can read about it in the hometown paper, or turn to the evening news and get a “sound bite” wrap-up of the day’s carnage. Even the “Pols” in Washington see it, and after having precipitated most of this problem themselves, they now promise an \$800 billion solution. Naturally, they want to point the finger of blame elsewhere, namely Wall Street, but savvy investors know differently and are not convinced the bailout offers enough hope.

In August, I wrote an article (see enclosed) for *Pacific Business News* warning of a meltdown in foreign markets and a surge in the dollar. Last night, much of Europe was down over 8% and today Brazil halted trading, as did Russia. The dollar and the yen are strong indicating an unwinding of the carry trade and repatriation of many dollars. Those who followed their friendly brokers’ advice to put half their savings overseas are now scrambling to get out of many emerging markets. At this point, China and Russia are down well over 60% for the year. In a nutshell, we’re approaching panic-stricken pricing and are probably due for a bounce of some magnitude in the U.S. stock market.

The key ingredient for a longer term up-trend and a new bull market is confidence. Investors must have confidence in our financial market mechanisms and confidence in our nation’s leadership. Frankly, after viewing the political process at work over this bailout package, and hearing the rhetoric of blame targeted at Wall Street (if not capitalism itself), I find it difficult to commit money for the longer term. To compound the problem, the current leader in the presidential race advocates raising taxes on the top 5% of American tax payers, who in his words can “afford” to pay more. While this message may resonate with the majority of Americans, we all need to understand that this 5% of Americans now pays 60% of the total tax burden and will likely sell assets this year in order to pay taxes while tax rates are still low. This same 5% of Americans comprise much of the investment wealth in this country and have little confidence in subjecting that wealth to a society that promises to punish them and confiscate more of any investment success they may achieve. This is where the rubber meets the road. This is the *real* issue behind the market weakness and lack of confidence.

As indicated earlier, we believe we are overdue for a bounce, but rather than commit cash reserves to buying more good companies, we are opting to sit tight and possibly even decrease holdings at higher prices. It seems prudent to watch the election results before making any major strategic move for clients.

Our typical client portfolio is already defensive and clearly out-performing the market as a whole. Nevertheless, we don’t like any negative return number and may have to become even more defensive in order to preserve capital. Rest assured, we will make that difficult call on your behalf if and when the time comes.

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