



Investor's Corner Newsletter-2/22/08

**Model Portfolio Returns:** (Note: all performance figures include reinvested dividends and, if applicable, capital gains. Portfolio performance is monitored using Morningstar resources. Print readers can access 2007 End of Year commentary and see more specifics regarding investment performance at [http://www.darecapital.com/news/080117\\_newsletter.pdf](http://www.darecapital.com/news/080117_newsletter.pdf))

	<u>2007</u>	<u>Through 2/22/08</u>
Modified:	17.11%	-6.25%
Pure:	5.53%	-2.10%
Model Trust:	14.41%	-5.62%
Challenge:	8.71%	NA
S&P 500:	5.14%	-7.81%
Bond Fund:	5.67%	0.78%

Readers, you probably don't need me to tell you that 2008 has started in challenging fashion. Though no one can explain why global capital markets do what they do, there are a lot of folks who spend their days and make their living trying to identify, quantify, and ultimately act on what they determine to be investable market strategies. To that end, it is worth batting around a few ideas that may have translatable investment value in the current environment.

**The importance of the bond market cannot be overstated-** Caution on the part of the global bond market is the main contributor to current market unease. The global bond market serves as the world's market-based bank, deciding what investments to fund and what interest rates to charge those investments, based on the perceived creditworthiness of the project and its backers. Note the word **perceived**, for many projects are funded or valued on the perception of ability to repay.

If the credit market gets spooked and perceives that there are increased repayment risks present among its borrowers or even among fellow lenders, it will tighten (or shut off entirely) new funding, leaving participating businesses, governments, and municipalities alike with funding issues. I use the analogy of the kids' neighborhood basketball game to illustrate this point, with the bond market being the kid at the game who periodically decides to take his ball and go home if things aren't going his way. In a nutshell, that's the bond market, and that's where we are today.

**The market's job is to test-**Periodically, all capital markets and market participants test (and are tested by) other markets and market participants. This is especially true for arguably the most important player of all, the Federal Reserve Chairman. Chairman Bernanke was given an 18 month honeymoon of relatively calm times after his appointment in late 2005 before the market collectively decided that he needed to be stress tested but good!

A related and perhaps somewhat esoteric thought involves the inverted yield curve of the bond market through most of 2006 and 2007. It has been said that an inverted yield curve is the most accurate predictor of a coming recession, though it is not a foolproof indicator. The conspiracy theorist in me wonders whether the bond market has turned its inverted curve hunch into **the perception of** a recession, thereby seemingly validating its predictive wisdom while creating a self-fulfilling prophecy. Again, it's a matter of perception versus ultimate reality. Stay tuned to see how this one ultimately plays out.

**There's a "book" for trading certain market scenarios-** I think that there's a blueprint or "book" for dealing with certain market environments. It may be more etched in the collective conscience of market participants who have seen the situation unfold in earlier times than written down somewhere, but it is well-enough subscribed to have some bearing on market behavior in certain scenarios. One of those scenarios might be dealing with a financial contagion. I think the "book" for trading a financial contagion such as the current subprime mortgage securitization issue says to sell anything related to the financial services industry--regardless of the underlying quality of the business/franchise-- and wait for the smoke to clear. That may explain why quality financial services companies are getting thrown out along with the not-so-quality ones. Many have noted the similarities to 1990-91, when a protracted savings and loan crisis took time to play out, and ultimately served as an historic low/buying opportunity for financial stocks.

**Another "book" says that \$100 oil leads to stagflation.** The classic way to profit from this is to own oil and commodities. Commodities have had a terrific 2008 to this point, earning double digit returns—and long time readers know my feelings about being overweight a variety of oil sector stocks in our portfolios—let's own as much oil as we can, and keep selling those Hummers! –see charts on P.3.

**Trends in the market can go on longer and be more extracted than initially seems possible-**Trying to apply logic and sniff out value in times such as these is a bit of a perverse exercise, because what we really have in front of us is the bond market throwing a hissy fit **simply because it can** and allowing a run on a wide range of credit instruments to be created. Are equity markets oversold? Yes. Is there long-term value in the current market? Prudent observers would likely say yes. Could the trend stay negative anyway? Yes. Again, it's a bit of a self-fulfilling prophecy until the bond market lightens up.

How do we combat these extreme conditions? Own best of breed companies in a space, diversify across negatively-correlated asset classes, put new money to work intelligently, and above all don't sell based on irrational fear or some overstated headlines. As for the media's influence on the financial markets, that's a story for another day...

**Sometimes stupidity can have global ramifications-**When the news broke on January 23 regarding the rogue French trader who was discovered to have lost \$7.9B of his employer's trading capital by hiding larger than authorized positions in his accounts, markets slowly began realize that the global selloff on January 21 may have been precipitated by the trader's employer dumping the entire position onto a thin global market (the US market was closed Jan 21 to mark Martin Luther King's birthday). Faced with global futures markets signaling huge losses, the Federal Reserve made an emergency 75 basis point interest rate cut on the morning of January 22. In a word: **Ouch**-maybe the bank should have consulted its trading room to determine how best to unwind the position?!

**Heard In Passing:** --Sir-you made an excellent point by asking: "Why should working stiffs in the heartland subsidize others' beachfront dreams?" along the coasts. Now if we could only get those in the heartland to realize that the rest of us are sick and tired of paying for their agricultural subsidies. From Letters to the Editor, *The Economist*, February 16-22, 2008

**Good investing, Will W. Woodard, III, CFP®**

Will Woodard is president of Dare Capital Management LLC, a Registered Investment Advisor firm in the State of North Carolina. Learn more about the firm at [www.darecapital.com](http://www.darecapital.com) Will and/or clients of Dare Capital Management LLC may own the investments mentioned herein.

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Charts:

S&P 500 ETF



Gold ETF



DJ-AIG Commodities Index MF



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