



Market Commentary-8/02/08

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.htm>)

	<u>2007</u>	<u>Through 8/1/08</u>
Modified:	17.11%	-8.67%
Pure:	5.53%	-3.93%
Model Trust:	14.41%	-3.90%
New Challenge:	NA	-8.63%
S&P 500:	5.14%	-12.90%
Bond Fund:	5.67%	0.61%

(Aside) Aah, out from under the yoke of appearing in general print circulation/hokey column title/1200 word mandate/having a deadline in the second full week of earnings season!

There are a lot of crosscurrents in the market-- I'm going to attempt to write this with what I would want to know from my financial advisor in mind. Some of this may get a bit arcane, but in times like this I think it's important that clients have a good picture of frankly where their advisor's head is at. Sorry if that sounds stilted or narcissistic.

Those of you who have talked with me on the phone recently have heard me fleshing out a theory on what happened to precipitate the oil spike we had in June. I want to advance the thought that on June 5th, when the employment rate came in higher than expected at 5.5%, the dollar spiked lower (weaker) and oil, which is denominated in dollars, spiked higher. The move was a two or three standard deviation move--meaning it was at the outside edge of all possible events--with the end result being that oil went up \$11 a barrel on June 5th.

At that point the severity of the move caused a group of opportunistic speculators (and by speculators I mean investment banks, sovereign wealth funds, hedge funds, etc) to go long crude oil (able to be traded on the NYSE under ETF ticker USO) and short the rest of the market. They were probably working together (either by being organized on the same trading desks or by using technology like instant messaging, or just drawing the same conclusions at almost exactly the same time), and it didn't take that much money (the entire market cap of USO being something around \$9BB at that time) to move oil higher. The move was aided by "timely" analyst actions, notably Morgan Stanley and Goldman Sachs (hmmm....) raising their price targets on oil to \$150 a barrel by July 4th. Ultimately oil reached \$147 on July 11th. During the move there was frequently a large buy (several hundred thousand to 1.5 Million shares) of USO between 1PM and 2PM every trading day.

The beauty of the plan--as it came to be realized--was that a sharp oil spike would create demand destruction, fear, and subsequent underperformance in the entire economy and the funds' short positions would benefit from the weakness...a self fulfilling prophecy if there ever was one. The piece of the puzzle that's caused me the most head-scratching is "Where were the large mutual fund companies that are long only-the Fidelitys of the world-during June?" I've come to the conclusion that they largely decided to make their shares available for shorting, told their fund managers to buy nothing, and took the month off.

I have to say "Bravo" for good ole' Capitalist ingenuity! The whole market got its socks scared off, with the following outcomes:

2518 S. Croatan Hwy, Suite E P.O. Box 1806

Nags Head, NC 27959 (252) 480-0156 www.darecapital.com

The market got really narrow-in other words not much was working to the upside. Intraday trading was overwhelmingly negative-more so than a typical "buyer's strike" as they're called. The jackals in the media did their normal baying, and pessimism/despair set in almost immediately. Financial advisors started having Armageddon nightmares (My record was four nights out of seven). The entire economy clinched up as if about to have its bell rung.

But there were good outcomes as well:

Congress got interested in an energy plan that involves something other than "What were they thinking?" ethanol.

Car makers finally realized they needed to think about making something other than Excursions (sorry Ford).

People suddenly remembered to be nice to their kids and neighbors and even family, and made a point to stop and smell the roses (Sure helped me that there were a lot of small fun surf days in June).

And then, as quickly as it came, it was over. Where does that leave us?

Well, my affinity for shopping the sales and willingness all too often to be a bit of a hard head and argue with the market has made some of my ideas look fairly stupid in the short run-but I'll bet any advisor on the Street could say the same thing about now. I'm actually very happy with how we are positioned. Let's look at a few key sectors:

Energy: I mentally declared victory on oil at \$120 a barrel, started trimming positions in the sector, and began putting new money to work in areas that would benefit from lower oil prices. Well, obviously I was early. We still benefitted in June from continuing to own oil exploration companies like Devon Energy, integrated oil names like Chevron, Nordic American Tanker Shipping, and commodities index funds that had oil exposure.

Our positions in the refinery sector, perhaps one of our biggest sector bets, were hurt by tight crack spreads and demand destruction. I still like the sector and I'm still buying due to the deep implied value. It was especially helpful that Valero and Tesoro reported earnings this past week, giving investors insight into their operations and financial position. Valero Energy CEO Bill Klesse commented on the July 29 earnings conference call that the market was valuing his company's refineries at 20 percent of replacement cost. That's a valuation that makes my ears perk up!

Verdict: Continue to own the entire sector, will buy Devon and Chevron on weakness, will look for short term downtrend on refiners to reverse as margins improve and valuations return to more normal levels.

Financials: There have been some real moves in this sector in the past several weeks, providing (along with the dollar strengthening and oil dropping) the best opportunity for leadership in the market at present. The good news has been precipitated by several events: better than expected earnings by the likes of BBT, Wells Fargo, Bank of America, and US Bancorp; a good housecleaning (and a one million share personal stock purchase) by Wachovia's new CEO and Goldman Sachs alum Robert Steel; and several market transactions involving the structured investment vehicles tied to mortgages that have been clogging the financial system the past year. **Verdict:** Have been buying BBT (with a 6.5% dividend yield at \$29 a share), Goldman Sachs on weakness, have started buying Wachovia. I think the fears of bank failures have been overstated, especially for banks in our investment universe. **Note:** Investment geeks may enjoy listening to BBT's July 17th earnings conference call for a template of how a conservative bank should report to its shareholders during times of market turmoil. Bravo John Allison!

<http://www.bbt.com/bbt/about/investorrelations/webcasts.html>

Broader Market: Here are some issues of concern. Reconciliation or improvement in any of these will provide grist for an upside move in the market:

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Credit spreads—In a word, they're tighter than they should be. Why does this matter? Tighter credit spreads reflect the Bond market collectively demanding higher interest or tighter terms for making loans. As Jim Reid, credit strategist with Deutsche Bank quipped in the July 12 issue of *The Economist*, if the spreads on investment grade debt accurately reflected default rates, everyone would end up living in caves. At some point credit spreads will moderate or else we have REAL problems.

Unemployment rate— Still ticking up, to 5.7% in the August 1 report. This number is worth watching closely. Upticks indicate continued softening in the economy.

Dollar weakening—there has been a lot of misinformation here. Everyone wants a weak dollar until they don't. A weak dollar is good for exporters. A strong dollar is good for investor and consumer confidence. It was bemusing to think back to the multilateral intervention when the Euro was trading below 85 cents to the dollar back in 2000, but offers to help the dollar were oddly not forthcoming from our Euro friends a couple of months back when the Euro was pushing \$1.60 and the Pound was at \$2.00 to the dollar. At present, America needs a stronger dollar for what it implies about the American economic system—even if that hurts exporters.

Nancy Pelosi, Chuck Schumer, Charles Rangel, Barney Frank—Folks, these are some of the most powerful people in America. Their collective sense of entitlement and feeding at the public trough is unbelievable. Be afraid, be very afraid. Hope you're listening, Obama!

Support by large mutual fund families and institutions—These market behemoths have to support the market by buying shares in order for it to rally. They have been notably absent on several occasions in 2008, leaving the market to twist in the wind, in the jaws of hedge fund traders and the jackals in the media. That is not a fun place to be for any length of time!

Conclusions: We have avoided a lot of carnage in 2008 but we've still been caught in some downdrafts. Frankly, they've been almost impossible to avoid. Being hedged in the different market sectors that we employ, especially commodities, has been beneficial when oil was spiking and fear was in charge. From here we remain cautious but invested wherever we see opportunity for above market return.

Ideas:

With lumber at 15 year lows and the construction industry in a state of historic blight, consider building or remodeling your house.

Buy banks like BBT with a 6.5% dividend yield.

Put some new money into the market to be invested over the next year. Put it with people you trust in companies and markets that you trust. Do not stay invested in people, companies, or markets that you do not trust. Monitor what people say versus what they ultimately do.

Improve your job skills and vow not to get sucked into the morass of media negativity about the world coming to an end. Tune out your relentlessly negative coworkers/neighbors/associates.

Make a point of taking in some music, or art, or literature that **really** inspires you.

Walk on the beach with your kids more.

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 Will and/or clients of Dare Capital Management LLC may own the investments mentioned herein.

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Charts:

S&P 500 ETF



Oil ETF



Russell 2000 Small Cap Index ETF



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