Commentary

The first quarter of 2008 was one of the most volatile in recent memory. Highlights of the quarter include the Federal Reserve's taking extraordinary action, the continuation of the housing debacle, the faltering economy, and a credit crisis that is much deeper than anyone ever expected.

The Federal Reserve came to the rescue of Wall Street as it assisted in the sale of Bear Stearns. A large portfolio of bad loans on Bear's books threatened to make the firm insolvent. Not only was the Fed's move to get involved in the sale of the investment firm unprecedented, but it also gave the public a view into how severe the crisis really is. The Fed feared that a collapse of Bear Stearns would have caused an environment of complete lack of confidence in our credit and financial systems. The depth of the credit crisis and the amount of leverage was mind boggling, but the real issue was that the underlying collateral was losing value.

Even with the rate cuts, the interest rates on home mortgages have not reached a point that would benefit the housing market. Even those who qualify for mortgages are having difficulty obtaining loans, as home valuations have fallen and lending requirements have tightened. House prices continued to fall across the country and default rates continue to rise. This is causing a drag on consumer spending which is one area that our economy has relied upon to boost overall economic growth.

With the credit markets in turmoil, higher inflationary pressure on food and oil, the economy is also showing clear signs of weakening. It is now evident that GDP growth of 0.5% in the fourth quarter of 2007 indicated that the economy was already slowing down and it did not improve in the first quarter. The employment picture is also deteriorating and looks to continue in the next few quarters. But the financial pain from higher unemployment and the increase in bankruptcies that typically mark a recession have not been felt yet.

The economy may or may not be in a recession, but one thing that became increasingly clear as we closed the quarter, was that high energy prices and the fallout from the financial and housing sectors were starting to take their toll on the almighty consumer. The University of Michigan Consumer Sentiment Survey has never been lower in its seventeen year history.

A particularly interesting note here is that although most people might assume that the financial sector would have led the market downside, technology issues fared worse. The technology sector fell 16% in the quarter, while the financials fell 14%. This is a clear sign that the economic malaise is not only affecting the housing and financial sectors.

There have been several bullish signals out there. Insider buying is picking up, hinting that the business climate might be getting better, and exports are up due to the weak dollar. This is not enough by itself to correct our current situation but it may create opportunities. We continue to look for undervalued and high growth potential opportunities in the market.

April 17, 2008