Commentary

I thought I would begin this quarterly commentary a little differently from those written in the past, as the entire landscape of Wall Street has changed forever. The continued collapse of the housing market and the subsequent credit crisis that has emerged has put pressure on our economy that we have not witnessed since the Depression. I think a quote from former Federal Reserve Chief, Paul Volcker, sums up how we got into the current crisis.

"The current panic is the ugly aftermath of the credit mania that took flight in the middle of this decade….The Federal Reserve kept interest rates too low for too long, creating a subsidy for debt and a global commodity price spike. The excess liquidity and capital flows this spurred became the fuel for the wizards on Wall Street and in mortgage finance who created new financial instruments that in turn fueled the housing bubble. As long as it lasted, nearly everyone inhaled the euphoria of rising prices and profits. Normal risk assessment gave way to excesses that always attend manias."

As mentioned above, we are seeing an unprecedented time on Wall Street. In September, the demise of Lehman Brothers, the buyout of Merrill Lynch and the government takeover of mortgage guarantors Fannie Mae and Freddie Mac brought fear to the market and to Main Street. The access to and availability of credit has dried up. This is affecting companies big and small as short term credit markets have essentially frozen and borrowing for payroll, inventory and operating capital has ceased. There has never been a time where the underlying lack of confidence in our banking system had more potential to cause systemic economic breakdown.

As the Treasury Department and the Federal Reserve convened to prevent a potential collapse of our financial markets, they brought bailout legislation to Congress that was supposed to bring some equilibrium to the markets. The partisanship that occurred prior to and after the vote was completely counterproductive. The bailout bill and the subsequent failure of Congress to pass it on the first vote exacerbated the problem. The time between the first and second votes allowed for a deeper look into the overall global economy and where it continues to be strained. The continued weak domestic housing market, weak employment and a very weak consumer spending number brought to light that the economy is likely headed toward or already in a recession. The prices of natural resources, especially oil, have come down from highs, but it has not helped the market as the credit crisis has been on center stage.

Once the bailout legislation was passed, the market did not react positively as it was not perceived as a cure-all to the crisis. However, there is a general feeling that the Fed and Treasury will do what it takes to fix the credit crisis and attempt to put confidence back into the banking sector. There was a coordinated global rate cut, but the market has continued to drop dramatically. We don't see the Fed's move as having significant impact as the critical issue is the availability of credit, not the level of interest rates.

To add to the market pressure, many hedge funds are liquidating equity positions. Hedge funds, that use leverage to amplify returns, have been hit with a large number of redemptions and as a result, have to de-lever themselves to satisfy redemptions. This has put tremendous downward pressure on the market.

In the past several trading sessions we have witnessed historic volatility, with down days far outweighing the up days. We saw the single biggest single day point gain ever in the history of Wall Street, but that had no follow-through as the big down days have netted losses for the month. As of this writing, 20 out of the last 23 trading sessions have seen triple digit downward moves.

In our current portfolios, we still hold good companies with strong earning potential and are well positioned for long-term growth. The fundamental reasons for our investments are still intact; however, we will see how this recessionary environment will begin to evolve and will take appropriate action within the portfolios as necessary.

The financial sector is at its cheapest valuation in decades. Obviously there are reasons for the low valuation, but, there are always those companies that emerge better positioned than before the crisis began. Brazilian banks, with their limited exposure to the United States banking crisis are still in favor even though their stocks have been hit hard. There are some interesting caveats to our current situation. As a result of the crisis that was created by the financial sector, there will be more regulation and more transparency in the industry. This regulation and oversight will in turn hurt innovation, hamper growth rates and profitability, so we need to be careful in those companies in which we will continue to invest.

Also, we still like those companies that are involved in oil and natural gas. The natural gas players will have a larger role in American energy policy in the future. Not only is natural gas abundant, but it is clean burning and even as the price has slumped this year, it has vast potential. We have seen the price of oil and natural gas decline, but we do not see this as a long term theme.

Technology issues had been relatively strong through mid – August, as they lacked exposure to the financial markets. In September and continuing into October, share prices were hit hard as questions arose about the global economy softening and the effect on future earnings. There are still exciting themes within the sector that we will be looking into.

I think that we are going to look back in a few years and know that these times are the greatest opportunities to invest that we have ever seen, at least in my time so far….

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