Commentary

While the first three quarters of 2007 were promising, the fourth quarter was very disappointing and unsettling. Challenges to the economy during the fourth quarter include: the worst housing crisis since the World War II, tightening credit, rising commodity prices, and a slowing in consumer spending. We also witnessed weak December employment figures.

The sub-prime lending programs that helped prolong the housing boom have completely broken down, and the subsequent credit crisis that has followed has been negative for the markets. The constant stream of bad news generated by the sub-prime mortgages and the credit crisis had the markets looking for some sort of catalyst. During the quarter, the Federal Reserve realized the housing contraction was a greater threat to the economy than earlier thought. As credit markets tightened, many traditional sources of funds were no longer available. This has led to an unprecedented tightening of credit in the second half of 2007 and is now is forcing the Fed to aggressively cut rates in early 2008.

We witnessed some of our most prominent financial institutions seeking capital from sovereign funds to shore up their balance sheets. The losses from sub-prime mortgages and other credit related instruments far overshadowed any positive news from within these corporations. Even now, the extent these financial institutions are exposed to the sub-prime sector is unknown.

Corporate profits are starting to weaken and we are looking to see to what extent the credit crunch hurt capital expenditure as this is a major factor in corporate earnings.

Consumer spending is also slowing. The weak Christmas season was an early indicator that the traditionally ever so strong consumer spending might be fading. The combined effect of a bad housing market, tight credit and a continued rise in commodities prices are starting to play in the minds and pocketbooks of consumers.

As we enter 2008, we will look to see how high commodity prices and a more cautious spending by consumers and corporations will affect an already weakening economy. The Fed will be in a position to lower rates, but will that be enough to provide the stimulus necessary to revive the economy. The Presidential elections will also create and interesting environment for all as we get into 2008.

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