



Points to Ponder

1. The credit market turmoil continues and appears to be building rather than subsiding.
2. Historically, financial and credit crises on Wall Street have been accompanied by plunging stock markets, followed by relatively quick recoveries. The wall of worry is becoming quite treacherous, yet the markets are relatively resilient.
3. Mega Cap stocks (largest 50) derive 47% of income from foreign sources in 2006. Up from 37% in 2000. Small Micro Cap stocks receive just 15%-20% income from foreign sources in 2006.
4. Bulls may have had the holidays but fundamentals for bearish case in 2008 are becoming apparent.
5. Federal rate cuts are not reaching the intended targets.
6. Relative valuation seems to support continued strength in the energy sector. In the 1974 to 1980 energy surge, the energy sector's PE relative to the S&P soared to an 82% premium. Today's energy sector still sells at a 10% discount compared to the S&P 500. Also during 1974 to 1980, energy stocks posted a 373% gain compared to 239% in its current cycle.
7. In some areas of the country, real estate is falling at an all time record.
8. Considering the sharp decline in housing prices it should seem logical we would begin a deleveraging process. That however was not the case last quarter. Just the opposite happened as this sector became even more indebted.
9. The National Bureau of Economic Research calculated the past four quarters GDP at 2.5%, well below potential which shows we are entering a period of growth recession where the economy expands at a pace less than its potential growth rate.
10. America is now "on sale". Europeans with the current Euro strength are taking advantage of this and starting to buy real estate and raising their investments in America. The question is whether or not now is the time to be a contrarian and look for the dollar to show strength.

Sources: Hoisington, Luethold, Evergreen, Schwab, GaveKal

Key Indicators Suggest

The potential combination of a remarkably weak US dollar, slowing US growth, concerns about interest and inflation rates, and a credit crunch with aftershocks possibly still ahead of us, leaves the feds and the market in a quandary. Thus, it appears we are continuing to head into a period of uncertainty with no decisive direction. Moderate economic expansion, slight recession, and/or stagflation are all possibilities in the upcoming year.

As we end the joyful yet hectic holiday and face our 2007 year end, we have the uncertainty of the gathering banking crises and a potential economic downturn with no guarantee the world economy will not take the same path.

The grievous experience of our past financial busts has taught us that when the banking system is in difficulties the mess may easily spread, like any contagion.

Strained banks lend less, reducing much needed money in the economy, which not only ties down companies but gives the ailing housing market a nice kick in the gut.

This raises key questions - Will the financial malaise aggravate the broader economy? What financial innovation will be infused and what will be the effects?

The hope is that the free market with help from the financial system will unblock the credit crisis and that the buoyant emerging international market expands its appetite for buying exports and recapitalizes the world banks.



Impact on Portfolio Design

With these indicators we find it is prudent to transition our portfolio models to have an increased exposure to alternative style managers, slightly overweighting large cap growth while substantially underweighting small and mid cap categories. The international managers are also cautiously over-weighted with the anticipation this category may start to moderate. Fixed income is positioned to take advantage of the weak dollar and additional uncertainty in the credit markets and the volatile interest rate environment.

No matter what direction the fickle fate of the market brings we are watching closely and feel your portfolio is appropriately positioned even though uncertainties loom. We wish for you to have the same peace of mind in 2008 as you have had in the past.

Your team at Triad wish your next year to be joyous, content and fulfilled. Make your mark in the world in 2008.

Larry & Dan