

The Advantage Advisor

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Market Commentary:

The financial markets are still trying to sort out in just which direction they want to go. The table to the right shows that returns were very fragmented during the month, with some stock indices moving higher and others moving lower. The cause appears to be a high degree of sector rotation within the indices as investors continue to shun financial issues (mainly banks) and seek out more stable sectors such as healthcare and technology.

The big news for the month is the sudden turn in the value of the US dollar. The chart below shows the US Dollar Index, which measures the value of the dollar versus a basket of foreign currencies. This allows us to get a more global picture of just where the dollar stands. The reason for this sudden upturn lies in the slowing global economy and recent comments from both the European Central Bank as well as the Bank of England. These comments insinuate that they may well have to begin lowering their key interest rates in order to provide support for their respective economies.

This turn in the dollar has had a sort of domino effect in the markets, driving down commodities prices - most notably crude oil and gold. Those in turn have caused inflation expectations to fall, and taken pressure off of our own central bank to begin raising interest rates

Market Statistics for July

Market Index	Closing Price	% Change
Dow Jones Industrial Average	11,378	0.3%
S&P-500 Stock Index	1,267	-1.0%
Russell 2000 Stock Index	715	3.6%
Shearson Treasury Bond Index	15,474	-0.1%
Dow Jones World Stock Index	260	-2.6%
Nasdaq Composite Index	2,326	1.4%

anytime in the near future.

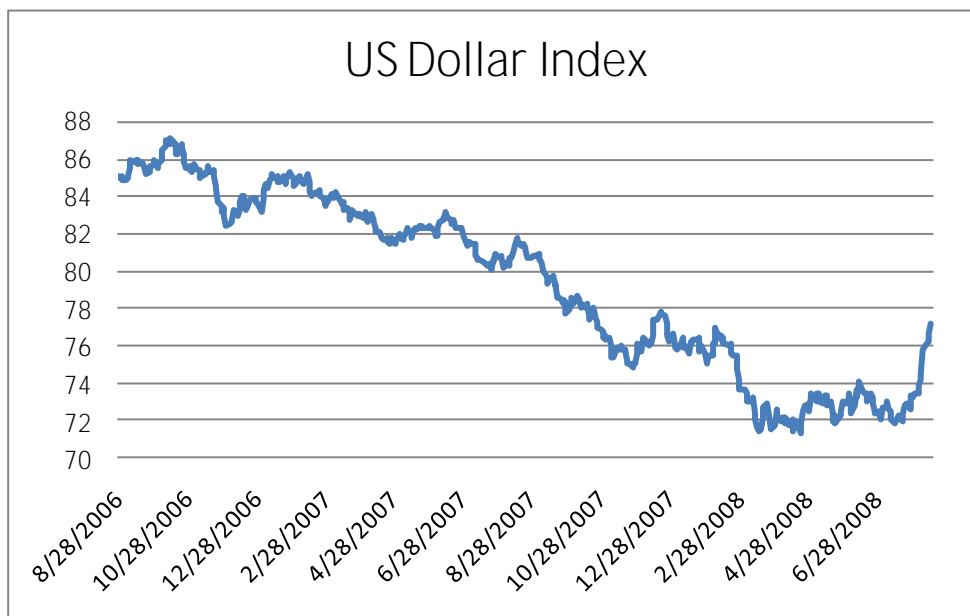
As you might be able to tell from the charts on the last page, we have done a little shifting in our stock based strategies this month. The drop in commodities prices caused us to do a little re-posturing in our Stock Strategy, reducing our exposure to that sector. Many large cap growth funds have increased their weightings in commodities related stocks in order to augment their performance. However, with the turnaround in that sector we want to move toward funds that have a more balanced portfolio within the large cap area.

In the Strategic Allocation strategy, we sold our international holdings, taking the profits from that position and preparing to reposition them into other sectors that look more promising moving forward. The other positions within that strategy remain unchanged, and will likely remain so for the near term.

Both the Bond and Current Income strategies remain basically unchanged. The Bond strategy continues to hold a mix of high quality and high yield debt. Ongoing fears in the credit markets have held down prices on those bonds, though they have come back somewhat from their fire-sale levels reached late last year. Right now, default rates in the high yield bond market stand at around 2.3%, which is historically very low. The historical peak default rate for those bonds was 10.5%. Most ana-

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US Dollar Index



The Economic Picture

Some exceptionally interesting developments have arisen over the past month:

The CRB Commodities Index has suddenly fallen to just above its 12 month moving average. A breakdown below that level would signal a change in trend to a bear market, and given the extreme nature of the recent run-up in prices, it could be a very long time indeed before we see those kinds of levels once again. In fact, it is not just the price of crude oil that is falling, but virtually every commodity is dropping in value. For example, the price of gold has fallen by almost \$200 an ounce in just the last 30 days!

I suspect that there is an additional impact on the demand for raw materials now that the Olympics are underway and China is no longer consuming most of the world's supplies. Global growth is indeed slowing and as a result the global demand for commodities is slowing dramatically as well.

Falling raw materials prices are good news on another front: Inflation. Inflation expectations have fallen back down to 5 year lows - not far above where they stood back in 2003 as the Fed was lowering interest rates to all-time low levels. Expectations are measured by looking at the premium investors charge for

Current Economic Position:
Stage 5 - Contraction

Economic Indicators

	Latest	Prior
Growth		
GDP	+1.9%↑	+0.9%↑
Productivity	+2.2%	+2.6%
Employment Cost Index	+0.7%	+0.7%
Capacity Utilization	79.9%	79.8%↑
Inflation		
Consumer Price Index	+0.8%	+1.1%
Core PCE Deflator	+0.3%	+0.2%↑
Implicit Price Deflator (GDP)	+1.1%	+2.6%↓
Sentiment		
Consumer Confidence Index	51.9	50.4
Unemployment Rate	+5.7%	+5.5%
Personal Income	+0.1%	+1.8%↓

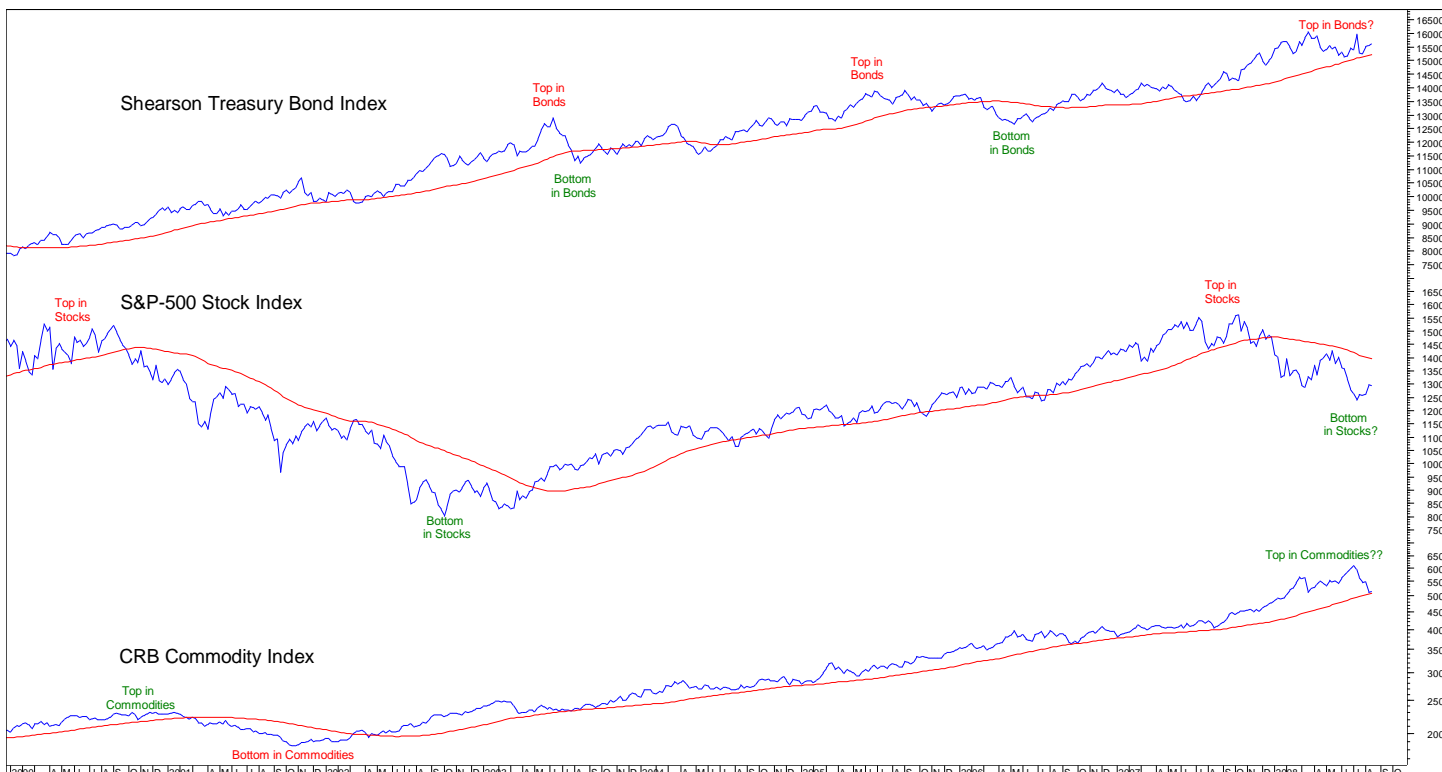
↑=revised up, ↓=revised down

Source: Moody's Economy.com

holding regular treasury securities over inflation adjusted treasury securities known as TIPS. The difference between the two, known as the spread, has dropped dramatically over the past 30 days right in line with the drop in commodities prices in the increase in the US Dollar.

The reason for the decline in inflation expectations is most likely the drop in gasoline prices, since that is the price that consumers and investors are confronted with on a daily basis. While gasoline prices have not

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Source for data: Investor's FastTrack

(The Economic Picture, continued from page 2)

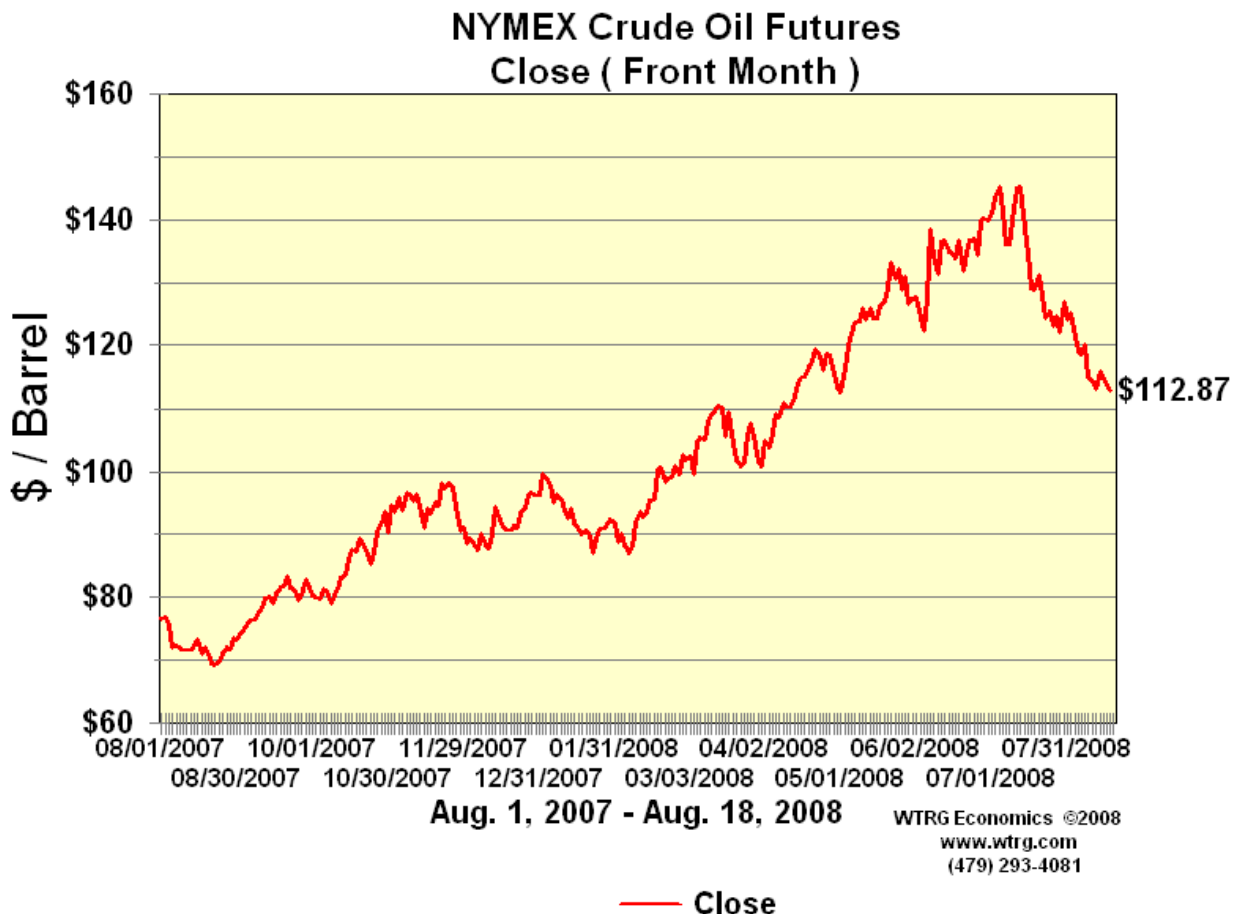
fallen at the same rate as the price of crude oil, they have certainly been dropping. According to AAA, regular unleaded gasoline prices hit a high of \$4.11 on July 17th, and have now backed off to an average of \$3.73. That represents a decline of 9.25% while the price of oil has fallen a whopping 24% from its all time high reached on July 11th. If that seems a little one-sided keep in mind that gasoline prices also did not increase nearly as much as crude oil itself.

An interesting development in the crude oil trading pits was a recent revision of trading data by the CFTC (Commodities Futures Trading Commission). This study revealed that 48% of the futures contracts for crude oil were controlled by speculators as opposed to commercial entities. In addition, one single trading firm controlled fully 10% of the oil futures that traded in July. That report makes it obvious that speculative trading bears most of the blame for the increase in oil prices. It also leads to a conclusion that once those prices begin to reverse, those same speculators will be forced to sell quickly and, according to Commodities trader Dennis Gartman, we could easily see oil back off

to \$80 per barrel before the market stabilizes once again.

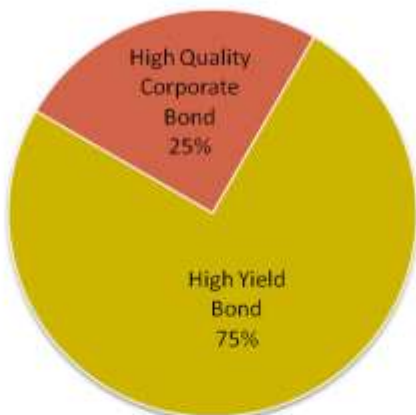
Finally, we turn our attention to the housing front. While it too is early to be certain that the trend will persist, it appears that housing prices may have bottomed out. According to data released by the National Association of Realtors, average home prices across the US rose 5.3% during the 2nd Quarter of 2008 and stand 0.4% above the 4th Quarter of 2007. Before we get too hopeful, please bear in mind that prices are still 7.6% below their prior year levels. However, this report could show that prices have finally reached a stable bottom point, at least on an average basis nationwide .

All of this information is very good news for the US economy. As a result we may soon see a shift in our current position from Stage 5 (Contraction) to Stage 1 (Late Recession), potentially bypassing an all-out recession (Stage 6). There are still plenty of unknown risks about, and so we don't want to jump too soon. However, we are watching our positions closely and creating plans for which direction we should turn once the way becomes a little more clear.

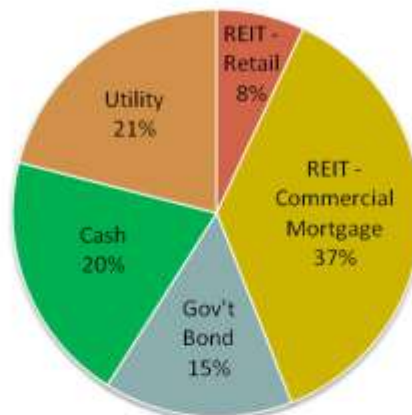


Current Investment Management Strategy Allocations

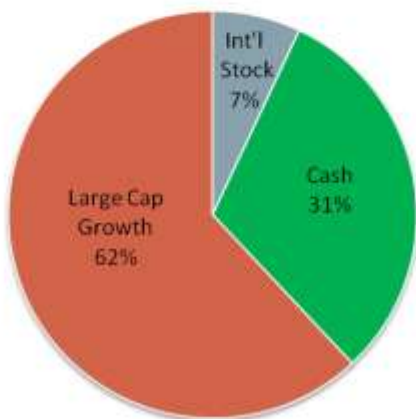
Bond Strategy



Current Income Strategy



Stock Strategy



Strategic Allocation Strategy



(Market Commentary, continued from page 1)

lysts expect that the default rates will rise from their current levels, but only to around 4%. Right now, these bonds are priced at a level that implies default rates well in excess of that 10.5% level - more like 15% to 18%. Therefore, as the economy improves and market fears subside, these bonds will be huge beneficiaries of that new positive bias.

We saw events unfold similar to this back in 2002 at the bottom of the dot-com bust and fallout from the 9/11 terrorist attacks. Over the next year our bond strategy gained an incredible 25% net of fees. While there is no way to predict with certainty that we will repeat that perform-

ance, what we can say is that things are lining up in a very similar fashion once again.

One issue that may keep things on hold for the short term is the typical seasonal slowdown in the financial markets that takes place here at the end of the summer months. While I do not expect to see a major drop in the markets, I do expect to see a bit of a pull-back in stocks and a fairly flat performance in bonds over the next several weeks. The good news is that the fall months are coming and that is typical a positive seasonal time for all of the financial markets.