

# 2nd Quarter 2008

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## Wake up - and smell the coffee

In the first half of the second quarter the markets began a partial recovery. This was based on a renewed confidence in the Fed and hope that the sub prime crisis was somewhat contained. In May, reality once again set in and the markets took a 12% dive. It looked like sub prime was back and it was accompanied by another 30% hike in oil prices. This left the broader markets down about 15% for the year and a full 20% from their peak in '07. The second quarter is now being labeled the worst quarter in 30 years and the worst first half since 1930.

Surprisingly, a recession has not been confirmed and many economists still feel that we may have only a mild recession. But, as the days go by it seems like the combination of high oil prices and a weak banking system is going to be way too much for consumers to bear. They simply can't afford both gas and coffee.

### The Pressure Continues

There is a lot going on and it is all connected. The real estate market continues to weaken. This puts pressure on the banks. When banks cannot renew credit, it puts pressure on small business owners and the consumer. This forces a slowdown in consumer spending which in turn forces companies to cut back and lay people off. At the same time, high commodity prices make it difficult for companies to make money. The headline casualty was Starbucks closing some 500 stores. {It is cheaper to make your own coffee}.

### The Squeeze

The high price of commodities is squeezing profits from all companies. A surprising example is an oil company like Valero that refines oil. It is seeing its



1958 Corvette Roadster

## The New Age

My first brand new car was a nineteen seventy something Subaru. At the time, I took a lot of flack for driving that Japanese piece of junk made with inferior steel and plastic parts. I should have paid like 1000 bucks more for a Buick. The Olds Cutlass was also pretty stylish.

But times were changing and we all knew that it would only be a matter of time before GM and Ford started making vastly superior cars.

But here we are 30 years later and GM's stock is now trading at a price not seen since the 1950's. Times changed. GM didn't. Investors are now trying to figure out if GM can rebuild itself or if it will fall into bankruptcy and eventually be dissolved.

In the financial world times have changed tremendously. General Electric is now trying to sell its appliance division among other things. It is hard to believe that GE is more involved in finance and entertainment than generators and appliances.

Corporate America has evolved. The world economy has also evolved and the age we

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stock at an all time low. The problem is it pays so much for oil that it can't mark up the gasoline and other end products high enough to make much of a profit. Valero's profit margins are squeezed. This is happening across the board to companies that make products from pasta to autos. {And coffee.}

### It Looks Like Oil

The price of oil is a huge problem but not our only problem. It is an oil price problem coupled with banking

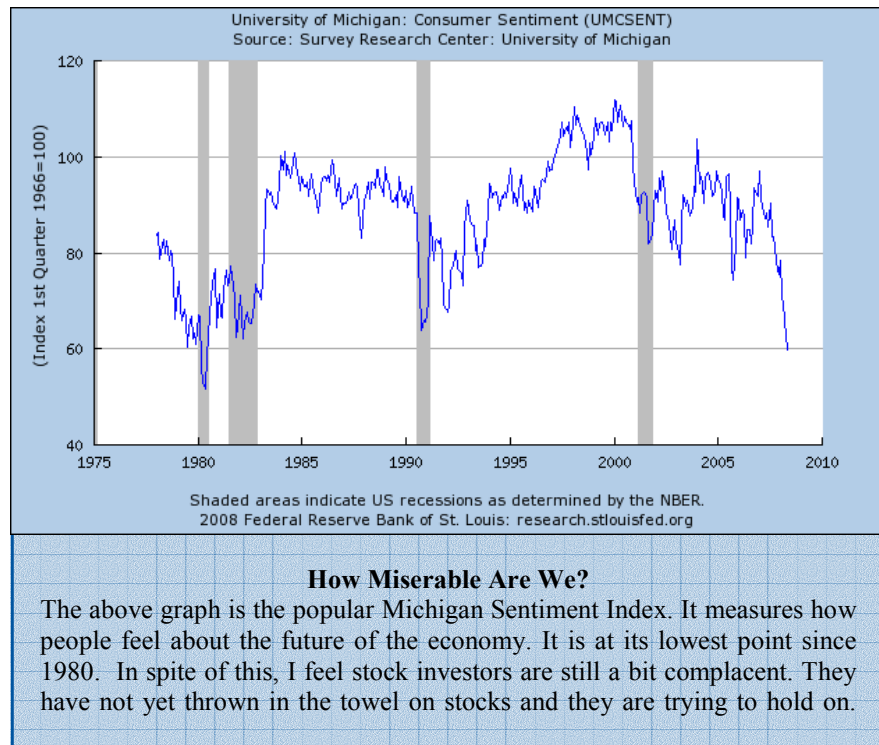
problems, deficits, the dollar and other problems that is making it so painful. Once oil stabilizes the economy could adjust. If, however, oil prices continue to march upward, fear will keep investors out of the market. I still sense, however, that most people think this isn't real and somehow everything will settle in. But even though oil prices may come down from \$140 per barrel, they will not get back to the \$14.00 they were just five years ago. Everyone will have to wake up and smell the coffee. {If your coffee looks like oil, add water and microwave for 49 seconds.}

### The Fed and the Dollar

The Federal Reserve's job is to control rampant inflation and deflation. At the moment we seem to have both taking place at the same time. This puts the Fed and the U.S. Government in a very difficult position. It is very hard for the government to bail us out. If the Fed lowers rates to help out the consumer, it will make the U.S. dollar less attractive to foreign investors. This also means the dollar will continue to make imports, namely oil, more expensive. If the Fed raises rates to slow down impending inflation, it will crush the consumer and possibly make the recession much worse. The Federal Government is now in the process of mailing checks to most Americans. This is a temporary band aid. It will be over soon. Bill Gross, the bond guru of Pimco funds, said that the U.S. Government will ultimately have to borrow and then spend massive amounts of money (\$500 billion) to bail out the economy. I can't argue with his opinion but I can't imagine the government spending this wisely. The ethanol program has been a disaster. Turning corn into gasoline has actually turned high oil prices into higher food prices. {Maybe they could turn coffee into gasoline.}

### Where Will It End?

It looks like it won't end but it will and the market will end it. There is no question that demand from developing nations like China and India is incredibly strong but some are saying that this mantra has been overblown. Rumor has it that China may be hoarding more oil than it needs just to get through any contingency at the Olympics. It has had a lot of problems and its short term demand may be



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overstated. As the Olympics end, China may face an export slowdown due to reduced U.S. demand and this can reduce its demand for energy.

So there is a feeling that today's price of \$140 per barrel may really be around \$100 with \$40 due to fear, greed, and speculation. In other words, the markets are way ahead of current demand and pricing way out into the future. {Rubbing coffee grounds into your hair will make it shine!}

### **Supply and Demand**

With all of our technology, it is hard to believe that we really don't know what the "available" supply of oil is. The word "available" is key because there is a lot of oil available but it is both expensive and politically difficult to get to. We also don't know a lot about the Saudi Arabian fields. The Saudis tend to keep secret a great deal of information about their supply and capacity. So it is possible that fields we are not thinking about will start to open up. At the same time, an economic slowdown will reduce demand for oil. Finally, there are alternative energies that are coming on board. The point is that it may not take much of a reduction in demand and a simultaneous increase in supply to cause an overall glut of oil. {Coffee grounds will keep snails out of your garden}

### **Politics**

We are moving toward a change in the political environment at the end of the year. Wall Street does not like change and does not know what the current candidates will do. This causes investors to back off of the markets. Health care, energy, and tax issues are primary concerns. We certainly need to make some changes, but the markets don't like the uncertainty. {Tea is cheaper than coffee.}

### **A Sliver of Good News!**

There are some very positive things working for us. As the days go by sentiment gets more negative. Extremely negative sentiment is good for stocks. Once everyone is out, they can only get back in. There is also a lot of money betting against the market or speculating on a market decline. When the markets start to move up, these "short" positions have to be closed and speculators are forced to buy. Cash has been pulled from the market and a lot of new cash is sitting on the sidelines. Investors simply don't know what to do with cash so it is idling in a money fund. When it appears that we are near a market turnaround, this money will flood the markets and cause a pretty rapid rise in stock prices. Finally, we have the foreigners. With the weak U.S. dollar and stronger foreign currencies our stock market is a good buy to overseas investors. This includes oil rich foreigners. They will have an opportunity to buy premiere U.S. property and stocks with their very strong currency. At the moment, they too are looking for some stability.

Meanwhile we are going to have to wake up and smell the coffee. We have to face up to the changes that will take place. The high price of oil will force us to conserve energy, move closer to our jobs, and drive smaller cars. If the government spends money, maybe it will be spent on alternative energy or enhancing public transportation and helping the job market. Maybe 8 cylinder 400 horsepower SUVs will go the way of fur coats. In the end, this crisis will be a good thing for our country and good things will come out of it. Already Starbucks dropped its price for a cup of coffee. What could be better than that?

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*Note: I am trying to keep updated comments on my web page [www.assetmanagementassociates.com](http://www.assetmanagementassociates.com). It is located in the lower right hand section under "Blog".*

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are moving into will be different. Investing today, more than ever, should not be based on a “buy and hold forever” philosophy. There are an awful lot of people, however, that still have a bulk of their money invested in GM or Pfizer or Citigroup stock. Here in Connecticut they have UTC. As we move forward, diversification becomes more and more important.

If the oil crisis is real, we are moving toward a new age and this will bring a lot of opportunity. It will also be very difficult for those companies that cannot adjust. GM could not make an adjustment to the future fast enough and they are suffering for it. Our job is to take advantage of the opportunities.

### Investing in a Few Scenarios

The banking industry is central to our economy. We cannot survive without finance so I am confident that somehow, either through government intervention or an injection of capital from domestic or foreign investors, the banking industry will have to recover. This makes the financials a good investment for the future. There will of course be casualties and some banks may fail or be forced to merge. It is hard to determine who those casualties will be. For this reason an index like the XLF, which represents the financial segment of the S&P 500, could be a good choice. Health care has been also in the doldrums for years. We need drugs, hips, knees and imaging equipment. In the long term all of these items will be in demand and health care will have its day in the sun. This makes Health and Finance the contrarian's play. It is the “buy or accumulate at the low and sell high in the future” scenario.

The energy sector is the hot sector and there is more risk because it does look like a bubble in commodities. It will be volatile as the hot money moves in and out. But the speculative cycle may not be complete and if energy prices remain at current levels, it will make sense to look for and drill for more oil. Also investing in coal, natural gas and especially the companies that service these industries will continue to make sense. We could also include gold in this category although gold does better with rampant inflation or concern of a disaster. So, all of these areas are in the “buy high and watch them go higher or blow up” scenario.

Although I remain conservative, I am trying to do both of the above knowing that we still can't rule out a surprise turnaround across the board. We only need stability in energy prices and some good news about either real estate or banking and all of this gloom and doom will quickly become ancient history. In fact, people will not be able to invest fast enough and the markets will more than recover. These are difficult times. Don't lose heart. Things will get better. While you're waiting, pour a coffee and relax. Make sure you have a thermal mug to keep it warm. Better yet, just get used to iced coffee! Have a great summer.

*John R. Ruocco*

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For more information and advisory fees, please contact John R. Ruocco at 1-800-208-8588 in South Windsor, Connecticut *The first consultation is always free.* Information, brochure, and form ADV part II is available upon request or log-on to [www.assetmanagementassociates.com](http://www.assetmanagementassociates.com).

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## Managed Fund Performance for 2nd Quarter 2008

	<u>Symbol</u>	<u>2005</u> <u>Total</u>	<u>2006</u> <u>Total</u>	<u>2007</u> <u>Total</u>	<u>2008</u> <u>YTD</u>	<u>Back</u> <u>Red. Fee</u>	<u>Annual</u> <u>Expense</u>	<u>Description</u>
					-			
<b><u>Bond</u></b>								
Amer. Cent. Inf. Adj. Sec.	ACITX	2.40%	0.00%	11.00%	<b>5.10%</b>	0.00%	0.55%	<i>Infl. Adj. US Gv't</i>
American World Bond	CWBFX	-2.90%	7.60%	8.60%	<b>2.90%</b>	0.00%	1.04%	<i>Int'l Bond</i>
Price Spectrum Income	RPSIX	2.10%	8.40%	6.20%	<b>-1.30%</b>	0.00%	0.80%	<i>Conservative Bond</i>
Pioneer High Yield A *	TAHYX	2.40%	10.60%	7.00%	<b>-1.80%</b>	0.00%	1.10%	<i>Junk and Conv.</i>
Vang. High Yield	VWEHX	2.80%	8.20%	2.00%	<b>-2.10%</b>	0.00%	0.26%	<i>Lower Quality</i>
<b><u>Balanced</u></b>								
Vang. Wellington	VWELX	6.80%	14.90%	8.30%	<b>-5.50%</b>	0.00%	0.36%	<i>60%/40% Stock Bond</i>
Vang. Balanced Index	VBINX	4.70%	11.00%	6.20%	<b>-6.10%</b>	0.00%	0.22%	<i>Index of Wellington</i>
Vang. Star	VGSTX	7.40%	11.60%	6.60%	<b>-6.80%</b>	0.00%	0.20%	<i>Several Vang. Funds</i>
American Cap Income Bldr	CIBFX	1.26%	22.00%	10.60%	<b>-7.90%</b>	0.00%	0.79%	<i>Diversified U.S. Int'l</i>
Dodge and Cox Balanced	DODBX	6.60%	13.90%	1.70%	<b>-11.30%</b>	0.00%	0.55%	<i>Bond Stock &amp; Cash</i>
<b><u>Stock funds</u></b>								
Invesco Energy *	FSTEX	54.00%	9.70%	45.10%	<b>24.00%</b>	0.00%	1.23%	<i>Energy - (phase out)</i>
Vang. Energy	VGEXX	44.60%	19.70%	37.00%	<b>14.10%</b>	0.00%	0.40%	<i>Energy Sector</i>
Invesco Gold *	FGLDX	32.60%	28.50%	22.80%	<b>13.50%</b>	0.00%	1.89%	<i>Gold - Sector</i>
Prudent Bear	BEARX	2.00%	9.10%	13.40%	<b>7.80%</b>	0.00%	1.76%	<i>Short-Gold</i>
Neuberger Genesis	NBGNX	16.40%	7.30%	21.90%	<b>3.90%</b>	0.00%	1.08%	<i>Small Cap - Closed</i>
Cohen & Steers Realty	CSRSX	14.90%	37.10%	-19.20%	<b>-2.60%</b>	0.00%	1.09%	<i>Diversified REITS</i>
Vang. Primecap	VPMCX	8.50%	12.30%	11.50%	<b>-3.30%</b>	0.00%	0.49%	<i>Growth</i>
Rydex Biotech	RYOIX	11.70%	-3.10%	5.70%	<b>-4.30%</b>	0.00%	1.38%	<i>Biotech Sector</i>
Neuberger Partners	NPRTX	18.00%	13.20%	10.10%	<b>-4.40%</b>	0.00%	0.90%	<i>Value - Aggressive</i>
Royce Total Return	RYTRX	8.20%	14.50%	2.40%	<b>-5.90%</b>	0.00%	1.20%	<i>Div. Paying Small Cap</i>
Price Science & Tech.	PRSCX	2.50%	7.10%	11.90%	<b>-7.10%</b>	0.00%	1.11%	<i>Tech.</i>
Fidelity Contrafund	FCNTX	16.20%	11.50%	19.80%	<b>-8.20%</b>	0.00%	0.99%	<i>Large Cap</i>
Vang. Health	VGHCX	15.40%	10.80%	4.40%	<b>-9.30%</b>	0.00%	0.29%	<i>Health - 25k Min.</i>
Vang. Explorer	VEXPX	9.30%	9.80%	5.10%	<b>-9.70%</b>	0.00%	0.70%	<i>Small Caps</i>
Mutual Discovery	MDISX	15.70%	23.40%	11.30%	<b>-9.90%</b>	0.00%	1.04%	<i>Specialty &amp; Int'l</i>
Price Blue Chip	TRBCX	6.00%	9.70%	13.00%	<b>-10.80%</b>	0.00%	0.96%	<i>Large Cap</i>
Investment Co. Of America	AICFX	6.80%	16.00%	5.90%	<b>-11.50%</b>	0.00%	0.70%	<i>U.S Growth - Large Cap.</i>
Vang. Index 500	VFINX	4.80%	15.60%	5.40%	<b>-12.00%</b>	0.00%	0.18%	<i>Index - S&amp;P 500</i>
Vang. Windsor II	VWVFX	7.00%	18.30%	2.20%	<b>-14.10%</b>	0.00%	0.42%	<i>Value</i>
Third Ave. Value	TAVFX	16.50%	14.70%	5.80%	<b>-17.30%</b>	0.00%	1.07%	<i>Diversified Value</i>
					-			
<b><u>International</u></b>								
1st Eagle Sogen Overseas A*	SGOVX	16.90%	22.30%	8.40%	<b>-2.90%</b>	0.00%	1.39%	<i>Smaller Cap Int'l</i>
1st Eagle Sogen Global A*	SGENX	14.90%	20.50%	9.90%	<b>-3.20%</b>	0.00%	1.34%	<i>Int'l with 38% US</i>
American Cap World	CWGFY	14.70%	22.30%	17.50%	<b>-10.00%</b>	0.00%	0.91%	<i>U.S. and Int'l</i>
Price International	PRITX	16.30%	19.30%	13.40%	<b>-10.10%</b>	0.00%	0.92%	<i>Diversified Int'l</i>

\* purchased at N.A.V. with sales fees waived on these loaded funds

Energy and Gold continued to gain value. Third Avenue tends to take advantage of distressed markets. Unfortunately, the distressed securities it owns are difficult to price because there are few buyers so it tends to get hit hard in this type of illiquid environment.

### Focus on Exchange Traded Funds 2nd Quarter 2008

Sector	Symbol	Percent of S&P	Total 2005	YTD 2006	YTD 2007	YTD 2008	Annual Expense	
Energy	XLE	15.25%	40.17%	18.01%	36.74%	<b>12.21%</b>	0.28%	Oil, gas and equipment.
Materials	XLB	3.74%	4.08%	18.22%	22.13%	<b>0.69%</b>	0.28%	Chemicals, materials, mining.
Utilities	XLU	4.10%	16.37%	20.85%	18.85%	<b>-2.88%</b>	0.28%	Water, electrical and gas.
Staples	XLP	11.35%	2.84%	14.47%	12.93%	<b>-6.90%</b>	0.28%	Retailing, personal consumption.
Industrial	XLI	11.24%	2.74%	13.50%	13.70%	<b>-12.18%</b>	0.28%	Aerospace, machinery etc.
Health Care	XLV	12.56%	6.41%	7.05%	7.11%	<b>-12.78%</b>	0.28%	Health care, equipment, pharm.
Discretionary	XLY	7.89%	-6.75%	18.41%	-13.01%	<b>-13.20%</b>	0.28%	Autos, apparel, hotels, media.
Technologies	XLK	19.71%	-0.31%	12.16%	8.99%	<b>-14.04%</b>	0.28%	Internet, telecom, computers
Financial	XLF	14.16%	6.20%	18.82%	-18.59%	<b>-29.64%</b>	0.28%	Financial services

Note: If you own all of the above in the specified percentage, you then own the S&P 500 - which trades under the symbol SPY - listed below.

Oil	USO	***	***	***	***	<b>50.30%</b>	n/a	Physical Oil
Coal	KOL	***	***	***	***	<b>25.00%</b>	0.65%	Coal Stocks
Steel	SLX	***	***	***	***	<b>24.65%</b>	0.55%	Steel Stocks
Silver	SLV	***	***	***	***	<b>17.46%</b>	0.50%	Physical Silver
Gld Sachs Resource	IGE	33.49%	35.98%	16.41%	33.47%	<b>14.41%</b>	0.50%	Energy - Resources
Gold Trust	IAU	***	***	***	***	<b>10.65%</b>	0.40%	Gold Bullion
Rydex Euro Currency	FXE	na	na	10.90%	14.54%	<b>9.65%</b>	0.40%	Inverse Dollar/Euro
Agribusiness	MOO	***	***	***	***	<b>7.83%</b>	0.65%	Agricultural Stocks
Gold Miners	GDX	***	***	***	***	<b>6.02%</b>	0.55%	Gold Stocks
TIPs Bond Fund	TIP	na	2.50%	0.28%	11.93%	<b>4.78%</b>	0.20%	Inflation Protected Securities
Water Resources	PHO	na	na	22.17%	16.74%	<b>-3.04%</b>	0.60%	Water Prod. & Supply
Cohen & Steers Rlty	ICF	36.75%	14.57%	38.50%	-18.21%	<b>-3.06%</b>	0.35%	Real Estate Inv. Trusts
Nuclear	NLR	***	***	***	***	<b>-3.90%</b>	0.55%	Nuclear Stocks
Japan	EWJ	38.73%	24.34%	5.95%	-5.48%	<b>-5.72%</b>	0.84%	Japan Index
Dynamic Biotech	PBE	na	na	2.31%	5.82%	<b>-8.22%</b>	0.60%	Biotech
Emerging Markets	EEM	na	32.62%	31.90%	33.08%	<b>-8.67%</b>	0.76%	Emerging Markets
Russell 2000	IWM	48.00%	4.46%	18.27%	-1.75%	<b>-8.90%</b>	0.20%	Small Cap Stocks
EAFE Index	EFA	29.80%	13.34%	25.81%	9.97%	<b>-10.86%</b>	0.35%	European Index
Nasdaq 100	QQQQ	49.67%	-1.14%	6.93%	19.14%	<b>-11.75%</b>	0.20%	Largest 100 NASDAQ
S&P 500	SPY	28.17%	4.80%	15.85%	5.14%	<b>-12.06%</b>	0.11%	S&P 500 Index
Diamond Trust	DIA	28.00%	0.70%	0.19%	8.79%	<b>-13.63%</b>	0.20%	Dow Ind. Average
Global Alt Energy	GEX	***	***	***	***	<b>-14.56%</b>	0.65%	Alternative Energy
Dow Sel. Dividend	DVY	na	2.81%	19.44%	-5.67%	<b>-21.75%</b>	0.40%	High dividend Stocks
China 25	FXI	na	13.30%	83.17%	54.75%	<b>-22.24%</b>	0.60%	China
Golden Dragon	PGJ	na	-3.20%	53.30%	63.27%	<b>-27.51%</b>	0.60%	China
Clean Energy	PBW	na	n	7.20%	58.50%	<b>-29.40%</b>	0.60%	Alternative Energy

The above is a brief list of some of the more popular indexes currently used. I added some of the indexes that simply hold commodities such as oil, gold and silver directly.