

July 2008

Dear Client,

Following the steep sell off in the capital markets in June, which saw the S&P 500 Index slide – 8.43% for the month<sup>i</sup>; it may be difficult to recall that the second quarter began with some optimism. A rally from mid-April through May encouraged speculation that a market bottom had been established. Risk appetite started to pick up as we saw large inflows into global equities and corporate bonds.

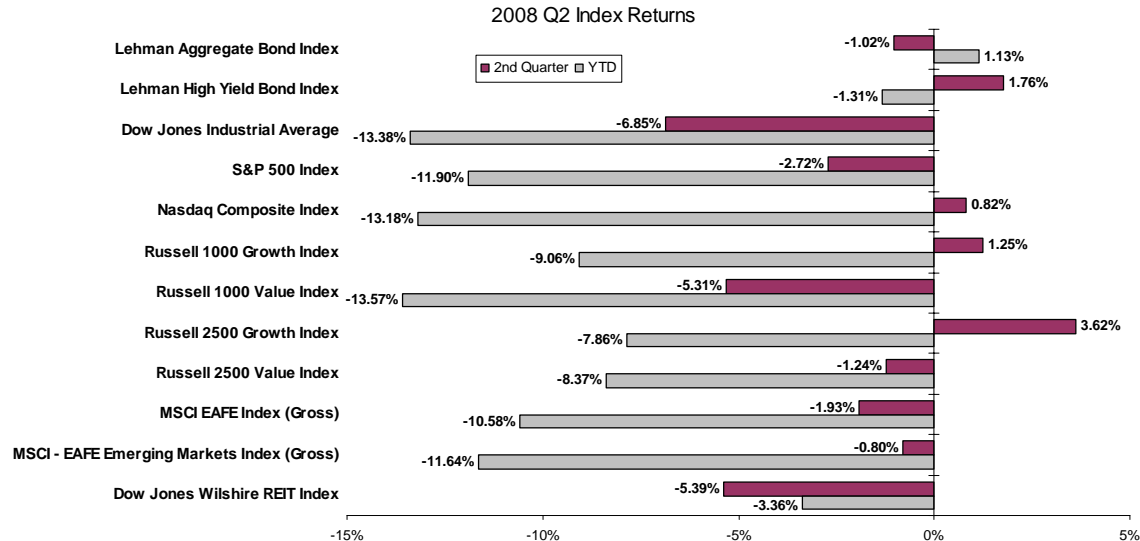
Unfortunately, optimism was cut short by a very difficult June for the S&P 500. A number of emotionally fraught issues, combined with some fundamental headwinds, pushed the markets into pessimism. Among the issues were:

**Commodities and Oil:** While high oil prices were being blamed on commodities speculators in some quarters, this analysis ignores significant fundamental issues. Demand for oil in emerging markets was up 147.7% in 2007<sup>ii</sup>, highlighting the continued growth in demand despite limited supply. OPEC may be close to maximum output and non-OPEC supplies are disappointing<sup>iii</sup>.

**Inflation:** Inflation is rising across the globe and central banks have differing views about how to manage it. The European Central Bank has so far focused on headline inflation – that is, the total inflation across an economy—while the Federal Reserve Board has focused on core inflation, which excludes food and energy costs. Inflation in Asia is particularly high and is starting to impact returns. Many Asian central banks have begun to raise rates<sup>iv</sup>.

**Earnings growth under pressure:** Early year earnings forecasts have proven to be too optimistic and have been substantially trimmed. S&P analysts have cut forecasts by half since the beginning of the year. Estimates have been reduced for 8 of 10 S&P industry sectors. (Information Technology and Energy were the exceptions.) Financing costs have slowed share buybacks, which had been a big driver of earnings over the last three years<sup>v</sup>.

The continued housing slump and credit crunch also contributed with the pessimism that finally took hold by the end of June. This table shows overall Second Quarter and Year-to-Date returns for the major indexes:



An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indexes are unmanaged with no associated expenses, and investors cannot invest directly in an Index. Past performance is no guarantee of future result. The index returns are all "Total Return" with dividends reinvested, which means the return includes not only the change in price for the securities in the index, but any income generated by those securities. Source: Bloomberg, Lehman Brothers, Zephyr Associates.

Some notable trends for the quarter include:

- Mid and Small Caps outperformed Large Cap stocks. In particular, Mid Caps proved to be nimble enough to capture upswings while retaining some of the defensive qualities of larger companies.<sup>vi</sup>
- Growth outperformed value.<sup>vii</sup>
- The best performing sectors were energy, utilities, materials and technology.<sup>viii</sup>
- The weakest sectors were financials, industrials, consumer discretionary and consumer staples.<sup>ix</sup>
- International trailed U.S. equities, while developed markets trailed emerging markets. Significantly, among emerging markets, commodities exporters (Brazil, Russia, South Africa) had positive returns while others (China, India, Korea, Taiwan and Turkey) had negative returns.<sup>x</sup>
- Shorter-term maturities outperformed longer-term maturities while treasuries trailed corporate bonds due to the strong start to the quarter.<sup>xi</sup>
- International fixed income trailed domestic fixed income for the quarter; however emerging market local currency debt provided positive returns.<sup>xii</sup>
- Commodities had stellar returns for the quarter, up 16.1%, driven by strong returns from not only oil but also agricultural products<sup>xiii</sup>.

## **The Outlook: Will There Be Good News Ahead?**

Those looking for good news can take some solace from the fact that the S&P 500 Index has lost 8% in a month 21 times and has rebounded to show gains two-thirds of the time<sup>xiv</sup>. Even without an immediate rebound, it is useful to remember that June 2008, while bleak, was not unprecedented. Corrections, even bear markets, are simply part of the investing cycle. Having a carefully considered long term plan can help guide investors through.

Another thought to keep in mind: just as a rising tide lifts all boats, an ebbing tide lowers them. Many investments have lost value based on the tide and not their intrinsic value. History shows us that the tide comes back in eventually, and many market-battered investments will have the potential to become opportunities.

No one can say definitively that the markets will reverse course and begin the next bull cycle. The important thing is to remain clear-eyed and seek opportunities as they arise.

If you would like to discuss the current markets or your portfolio, please contact me at XXX-XXX-XXXX, we welcome the opportunity to spend time with you reviewing your financial objectives and answering any questions you may have.

Thank you for the trust you have placed in us.

Sincerely,

Thomas Carreras  
Carreras Financial Services, Inc.

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<sup>i</sup> Standard & Poor's

<sup>ii</sup> Ned Davis Research

<sup>iii</sup> Goldman Sachs

<sup>iv</sup> Financial Times, Avatar Associates

<sup>v</sup> Standard & Poor's

<sup>vi</sup> Russell Indices

<sup>vii</sup> Russell Indices

<sup>viii</sup> Standard & Poor's

<sup>ix</sup> Standard & Poor's

<sup>x</sup> MSCI Barra

<sup>xi</sup> Lehman Brothers

<sup>xii</sup> Lehman Brothers, JPMorgan

<sup>xiii</sup> Dow Jones Indices

<sup>xiv</sup> Standard & Poor's