

## VOLATILITY RETURNS

The stock market struggled to stay even in the first quarter and showed mixed results as the Dow Jones Average finished less than 1% lower while the S&P 500 index gained less than 1%. Those relatively modest percentage moves understate the wild ride investors experienced as market volatility increased significantly. Indeed, a sharp 7% market decline in mid-quarter turned out to be the largest market correction in four years. Thanks in part to comments from former Federal Reserve Chairman Alan Greenspan, investors began to ponder the possibility of an approaching economic recession. ***Typical Pring Turner Capital Group portfolios performed well during the turmoil as ample exposure to high quality bonds, preferred stocks, and cash helped your portfolio generate steady gains and outperform stock indexes.*** Our most recent newsletters warned of a coming economic slowdown and stocks may only now be sensing the potential for earnings to temporarily disappoint investors. We repeat those concerns today and unfortunately think investors may have to stomach a few more “Maalox moments” in the months ahead.

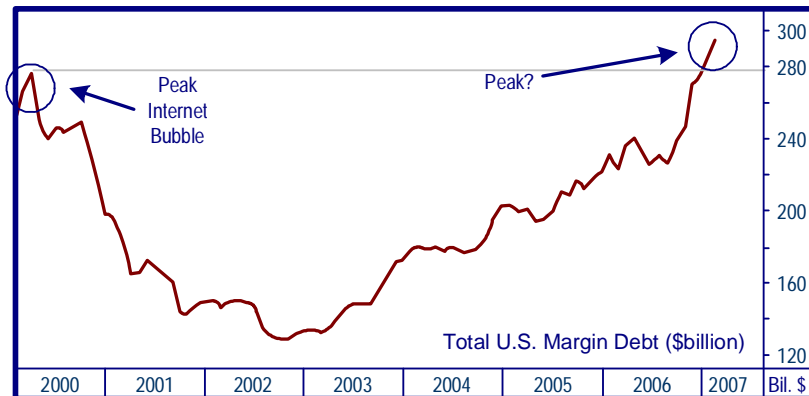
We diligently sift through numerous economic research reports and analyze market data in an effort to gauge risk versus opportunity. Our long-standing goal for you is to generate reasonable returns while limiting risk. The recent up tick in market volatility serves as a careful reminder that risk management is a critical element in long-term investment success. One important gauge of market risk worth noting is the recent explosion in the use of margin debt (borrowing money to buy stocks). Margin debt now stands at an all-time high of \$295 billion, even higher than the level of March

2000! Not coincidentally, that level of speculation marked the peak of the internet bubble and ushered in a nasty multi-year bear market for stocks.

***Historically, high levels of margin debt reflect an***

***increasing speculative sentiment, where greed and complacency override prudent portfolio actions.*** For now, our preference is to emphasize defensive portfolio tactics (quality and income!) to protect client wealth. We will patiently wait for better stock market opportunities to build wealth as the year progresses.

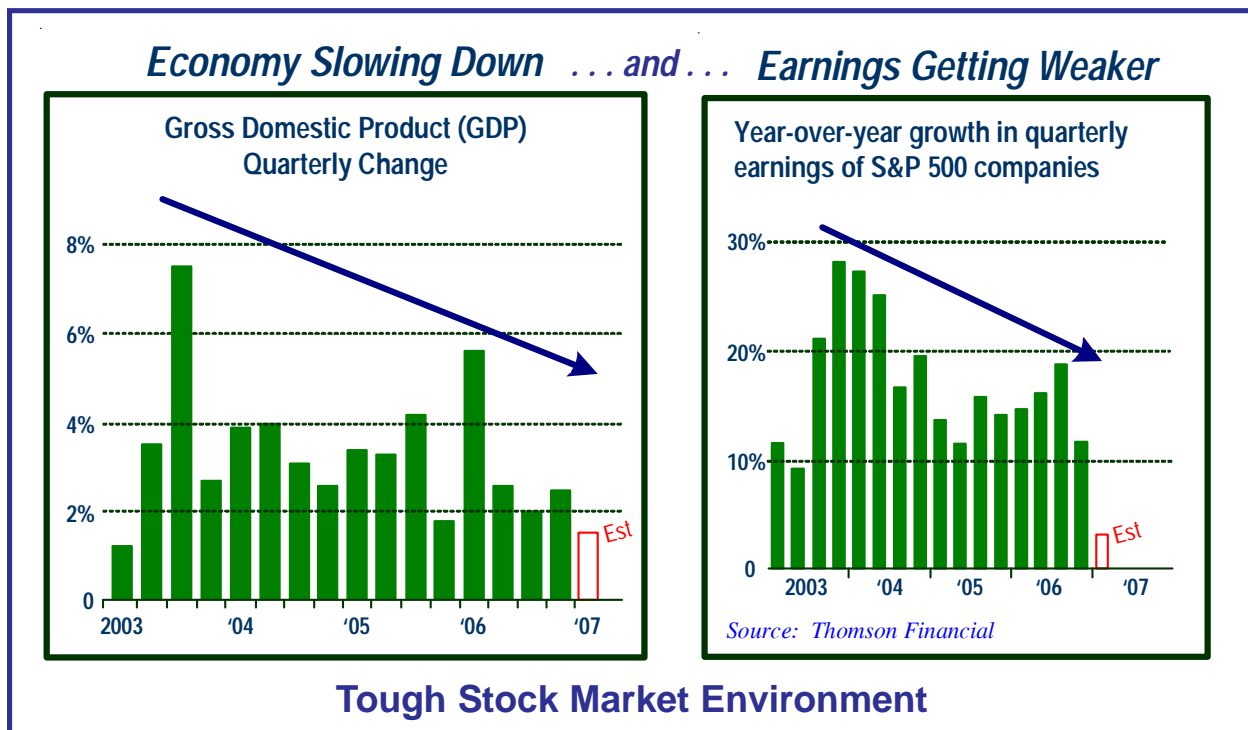
**Record Margin Debt - Growing Faster Than Stock Prices**



**Investors: Proceed with Caution!**

## HOUSING HANGOVER OR THE SUB-PRIME LOAN MESS

Over the last year, our quarterly newsletters warned a housing and real estate slowdown would eventually spillover to the rest of the economy. Today, not a day goes by without seeing another report concerning stories of “sub-prime” loans gone south, record inventories of unsold homes, and the huge increase in home foreclosures. We believe the next piece in the story will describe how housing related job layoffs will compound an already difficult situation. *A weak real estate market means less consumer spending and that translates to a meaningful economic slowdown and falling corporate earnings. At best, for investors, stock prices will continue to tread water as the pace of the economy and corporate earnings slow measurably.*



## THE GOOD NEWS ABOUT AN ECONOMIC SLOWDOWN GOES TO BOND INVESTORS

*Evidence of a slower economy will eventually lead the Federal Reserve to lower interest rates, thereby rewarding bondholders with higher prices. Your portfolio has a generous exposure to bonds, preferred stocks, and other stable, income-producing investments that shine in this environment.* So far, it is still a bit early to expect a change in interest rate policy by the Federal Reserve. While the economy is indeed slowing down, inflation has stayed stubbornly high (gas, groceries, medicines haven't gotten cheaper) for the Fed's liking. What will it take to persuade the Fed to finally switch gears and lower interest rates aggressively?

In our opinion, monetary authorities will focus on three important benchmarks before shifting policy to a more investor friendly atmosphere. First, is there visible evidence that housing speculation has been wrung out? Yes, it is safe to say that process is well underway. Second, is the unemployment rate moving up to the point that Fed officials are worried about the economy? No, although manufacturing, construction and financial companies have recently made large layoff announcements, we are still early in the process.

The unemployment rate will likely ratchet up as the year moves ahead. Third, has a headline grabbing financial crisis popped up to signal the Fed has overstayed their tight money stance? So far, we have not seen any “front page” disasters that typically motivates the Fed to lower interest rates. ***In order for the Fed to become totally friendly to common stock investors, we are likely to see at least two of three conditions on our checklist met.***

We recognize it is sometimes tough to be patient but our decades of experience has shown us over and over again, that patience is a friend to the conservative investor. In the meantime, we are comfortable in a portfolio protection mode, searching for solid values to add to your portfolio.

***We will be far more active when we deem conditions are safer to go back on offense and more aggressively build portfolio wealth.*** Once again, thank you for your continued confidence. Please feel free to contact us with any questions regarding your portfolio.

### “Fed Friendly” Checklist

Housing Cool Down?

Unemployment Jumps?

Financial Crisis Headline?