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CMA Update: FED cuts interest rates 3/4%, which adds significant stimulus to most parts of the US economy.

According to many financial market commentators the Federal Reserve has been sluggish or late in recognizing the need to cut interest rates in order to stem the decline in housing construction and invigorate activity in home resales. Yet, the classical mandate for the FED to act in response to economic matters is to analyze employment, growth and inflation trends across the entire US economy and then act with monetary policy action (cut or increase rates) based upon "actual events and current statistics", not on expectations alone.

The FED's latest review of the economy was done a week ago, via the Beige Book Report, which covered the period from mid-November thru end-December. It showed stable to mixed economic conditions and employment trends outside of the housing sector. (We included highlights of that report in our Jan 18th Update.) It did not indicate that a recession was occurring, or that it was probable. Hence, the FED has not cut rates until today, and today's cut was motivated by developments in the stock market, not the overall economic situation. In summary, the economy...outside of housing...has more monetary stimulation than it really needs.

The housing sector and automotive sales have been the only US economic sectors that have "experienced" a decline in activity, whereas the rest of the economy is doing fine. The FED's action today to cut rates by 3/4%, may be considered late or tardy by some, but is a boom for all sectors of the economy....and will add even greater growth stimulus to economic sectors (excluding housing and autos) that don't really need the stimulus. In our estimation, there "will not" be negative growth in any quarter in 2008 to equate to a recession situation, and late 2008 will see a growth boom.

Certain sectors and specific companies should experience above trend revenue growth and earnings improvement from this added monetary stimulus, in addition to the stimulus from the US dollar's decline in 2007. Real estate investment trusts (REITs) that use moderate debt leverage to finance their income property portfolio holdings will see lower interest rates on new fixed rate debt and lower interest costs on current floating rate debt. Coupling this to the potential for higher lease, rent and operating revenues, operating income and FFO should get a boost thru 2008. This would apply most heavily to the office, hospitality, industrial and apartment sectors. Less positive impact to retail shopping REITs where discretionary consumer retail spending may not get such an upside lift until housing starts its recovery. We hold REITs in hospitality, office and industrial, which include: Ashford (AHT), Duke (DRE), Hospitality Properties (HPT), HRPT (HRP), LaSalle Hotels(LHO), Sunstone Hotel (SHO), Strategic Hotels (BEE). In the international hotel owner/operator sector, this improved revenue climate and lower rates should assist Marriott (MAR) and Starwood (HOT), which we own in portfolios.

Beyond the income property sectors, we see economic pickup in revenues (domestic and international) and more opportunities in earnings growth now with the FED rate cut for the industrial, consumer cyclical, consumer discretionary and technology sectors. Also, many of the companies we hold in portfolio have indicated their desire to buy back more of their common shares in the market to enhance "earnings per share", a benefit to shareholders. The recent decline in these companies share prices will be a benefit to that policy. The companies that we

hold, which fall in to these categories noted above include: MMM, AMD, Alaska Air, Alcoa, Apple, Avon, Broadcom, Coach, Dell, Disney, DreamWorks, EBay, EMC, GE, Harley-Davidson, Home Depot, Intel, Kohls, Liz Claiborne, Lowes, Macy's, Motorola, Nordstrom, Panera, Saks, Starbucks, Tiffany, Walgreen, Whole Foods, Yahoo.

The FED's rate cut was "overwhelmingly" targeted to benefit the banking and financial sectors that have felt the most distress from the sub prime mortgage crisis and credit freeze to some sectors. We hold B of A, JP Morgan, Barclays, Wachovia and National City. Lowering rates by 3/4% is a huge reduction in the banking industry interest cost. This reduction from 4.25% to 3.5% is an 18% interest cost reduction. Granted that banks are typically earning profits on the spread (loan rates vs deposit rates), bank's carry a lot of fixed rate assets that will benefit earnings from lower carry costs (lower deposit rates). The "boom potential" to the economy....via banks...is that prime rate now drops 3/4% and the many companies in the economy that are not stressed from the housing or sub prime mess will experience lower borrowing costs on existing debt (benefits company earnings), and the lower rates justify more cap-ex spending as interest cost drops and economic outlook improves.

Other financial companies such as AIG and Allstate that we own will benefit as their typical fixed rate assets in portfolios gain in value as interest rates fall giving them up side in market value on their portfolio holdings to likely, more than offset, any write downs they have done on mortgage debt holdings.

In the non-common stock area of investment securities, most investors hold fixed income securities that have fixed interest rates spanning many years, from say 5-30 year maturities. These are typically corporate bonds and preferred stocks. As short term interest rates fall, bond prices go up! We see that the FED's rate cut today of 3/4% will benefit fixed income security prices. Further benefit will arise as the economy lifts off from the rate cut and rising business activity across the board causes corporate credit risk factors (spreads) to narrow, so that the combination of FED rate cuts and narrowing credit spreads gives a major lift to fixed income securities prices thru 2008.

This morning, the major indexes DOW and S&P500 dropped dramatically, and 2 hours since the open, the market has recovered a lot. The major and regional banks stocks are up 5-10%. Lowes and Home Depot, reflecting the home improvement sector (very credit sensitive) are up 8 & 9% each. In major retailers, Kohls is up 8%, Liz up 6.5%, Saks and Macy's up 5 and 6%. REITs are unchanged to up 6%. Most all tech stocks are still down on the day, as they are "least credit sensitive" in that tech companies usually do not have debt, and much of their product is "cash-purchased". Their rally will likely occur later in time.

On a personal note, the recent turbulence in major market indexes and individual stock prices in general create a lot of anxiety in all of us, especially me as a money manager. My personal investments are in similar stocks and bonds that my clients are in. I always look at situations like this as "abnormally normal"...meaning that the stock market does a lot of crazy moves in the short run....goes up too much and down too much based upon public expectations.

Very often, and I mean very often, the gyrations in the indexes have little correlation to changing business conditions at the company level of the firms that are in these major indexes. Companies like GE, MMM, Intel, Dell, Alcoa, Avon, Disney, DreamWorks, EMC, Marriott, Saks, Tiffany to name a few have indicated that their businesses are doing a lot better than they did in 2006. Every hotel REIT that we own and follow are seeing rising positive business results from growth in leisure travel and in-bound foreign tourism. Market mentality at this time has tried to "connect" the sub prime mess to a lot of unrelated business sectors, and that these other areas will feel pain. This has not been the case or the facts up thru the close of 2007 and the FED's Beige Book Report. Again, 2008 in our estimation will be a recovery year for housing and a boom year for other sectors...Thank You FED.

