

Capital Management Associates, Inc.

Investment Management.....Financial Planning.....Estate Planning.....Tax Strategy

Charles J. Dushek, President

801 Warrenville Road, Suite 195, Lisle IL 60532 Internet: www.cmaadvisors.com

Phone: (630) 963-4235 Fax: (630) 963-4236

Email: chuckdushek@cmaadvisors.com

December 13, 2007

How Does the Economy Look Right Now?....And, How Are Your CMA Investments Positioned?

Obviously, we have a lot of current turbulence in the stock market that is reflecting the unsettled condition of the housing market and sub-prime debt out there. How material is this housing and mortgage debt situation to the health of the US economy? Will it strangle growth, shut down credit markets, or ruin major banks?

First, let's look at the magnitude of housing in the context of the rest of the economy. As of Oct 2007, single family home sales are down to 5,000,000 in turnover or resales from peak levels of near 6,500,000 in 2004, 2005 and 2006. This is just turnover, not new construction. This is a loss of business to realtors and mortgage bankers, but not such a big shock to US total output. The existing home inventory overhang is at 4,400,000 of unsold homes as of Oct 2007. This is about 1,000,000 higher than the 2006 housing boom average inventory level. It is a problem that is depressing resale house prices, causing price erosion of 6% from peak values as of mid 2006. This is not a disaster though in that house prices went up over 100% since 1995...a 6% correction is modest by most market adjustment standards.

I think the biggest impact that investors are worried about is the slowdown in the residential construction industry. Yet as glum as it appears on the surface, a housing slowdown has only a small effect on total US economic output. This year, US exports to other countries are booming, growing at a 19% annual rate. Just the monthly export growth increase of \$20 billion per month can offset the loss of 100,000 housing starts per month (\$200k avg cost per house). This export growth has a way to go on growth considering that the US\$ has declined a lot just this past year....by over 20% against the Canadian\$ and about 10% against the Euro. In summary, US export growth alone of near \$240 billion per year is adding about 2% to US GNP output of \$13 Trillion per year. When the US housing market and new construction recover in late 2008 (my guess), coupled with declining US interest rates from the FED, and the back-end loaded export growth and in-bound foreign tourism growth to the US....the US economy is going to BOOM in late 2008 and 2009.

The second factor that is holding back bullish expectations for the US economy is the so-called "credit crisis". This means that traditional lenders to housing, consumer lending, capital investment, corporate acquisition financing, and general commercial lending to businesses has slowed due to tighter loan underwriting standards and capital reserve reductions at banks. The credit pendulum has just shifted from "extremely generous with lax standards" to judicious underwriting standards. Lending has not stopped; it is going through a more responsible process, especially for housing.

New credit granting, as far as availability of funds to qualified borrowers, is as good as it can get...and getting better. The FED has cut interest rates 3 times since August, Fannie Mae and Freddie Mac, the government sponsored housing lenders has added massive new capital and are positioning to provide more new loans to qualified home buyers. Further, The FED and four major central banks are now offering a special credit facility to major banks around the world to borrow against all the eligible debt collateral they want to put up. The central banks are basically bailing out all the major banks to get them back into the lending game.....what a deal!

In my estimation, the US economy is now at the trough or low point of the next major growth boom fueled by: Government mandated mortgage rate freezes, Lower interest rates from the FED, Cheaper US\$ that is booming exports and in-bound tourism, A national election with economic perks, Billions coming in to US companies from foreign sovereign investment funds, Expansion of the Internet, just to list the low

hanging fruit. Productivity is great in the US +4-6% annually, we have consistent job growth month to month, and the only inflation we have is energy-price induced that has nothing to do with monetary or fiscal policy irresponsibility....China demand for oil and Arab supply control.

On stocks, the above scenario should translate into some great opportunities for investors on themes that are "playing out now", not themes that one has to imagine will materialize in the future. The weak US\$ will benefit export industries, US travel and hospitality, and multinational companies that have high foreign revenues and earnings. The FED's lowering of interest rates will benefit property REITs in three ways: Their dividend yields of 5-11% are very attractive to income investors facing falling CD and money market rates, REIT debt refunding can be at lower interest costs in the future to expand profits, and if there is inflation from loose FED monetary policy, high quality income real estate goes up with the price index....an inflation hedge. On pure fixed income securities investing (preferred stocks and bonds), these are now yielding 8-13% annual interest income returns from high quality issues....the 10 year US Treasury pales in its 4% yield in comparison to these securities.

Understanding Your CMA Portfolio Investments

CMA portfolios have 4 classes of securities in them: Pure growth stocks, especially with foreign business and earnings, High dividend common stocks, REIT real estate investment trust stocks, and Fixed income...preferreds and bonds.

Growth stock holdings include: Alcoa, AIG, Allstate, AMD, Amgen, Avon, Barclays Bank, Broadcom, Coach, DELL, Disney, Dreamworks Animation, Alaska Air, eBay, Estee Lauder, EMC, GE, Harley-D, St. Joe, Nordstrom, Liz Claiborne, Eli Lilly, Lowes, Marriott, MMM, Motorola, Panera, Starbucks, Tiffany, Texas Inst, Walgreen, Whole Foods & Yahoo. 23 of these companies have foreign sales and earnings exceeding 25% of their business.

High dividend common stocks (yield shown) include: B of A 5.9%, Citigroup 6.9%, Citizens Comm 8.1%, Lilly 3.1%, GE 3%, Home Depot 3%, JPMorgan 3%, Nat City Bk 9.3%, Wachovia Bk 6.3%, Washington Mut 13%.

REITs for income (yield shown) and property appreciation: Ashford Hospitality 10.9%, Duke Realty 7.2%, Hospitality Properties 8.7%, HRPT Properties 10.6%, LaSalle Hotels 5.7%, Strategic Hotels 5.3%.....These are the dividend rates, and all these REITs hold back about a third of their free cash flow FFO to use for new acquisitions for property portfolio growth.

Fixed income...Bonds and Preferreds with interest yields of 7-13% include the following issuers: Cooper Tire, Dana, Dole Foods, Fairfax Fin, Ford, GM, Liberty Media, Standard Pacif, Visteon, Bancorpsouth, Berkshire Prop, Brandywine Prop, AON Ins, Felcor Lodging, LaSalle Hotels, Mid-Amer Apt Prop, Northstar Realty, Post Prop, Citizens Comm, Dayton Power & Lt, Sunstone Hotels, JCPenneys, CBS Corp, Duke Electric, Goodyear Tire, Provident, Sherwin Williams, Harris Bank, Hilton Hotels, ING Group, El Paso Gas, Tribune Holdings (owns Chicago Cubs), Strategic Hotels, Telephone & Data Systems Inc, All issuers are current on interest payments.

Our clients' investment strategies are a blend of securities from each group. Low risk/high income clients hold Hi-Div commons, REITs and Fixed income portfolios. Young clients seeking high asset growth potential typically hold Growth stocks, Hi-Div Common and some REITs. Balanced portfolios hold near equal weightings across all 4 groups.

Please contact Chuck Dushek at 630-963-4235 for any discussion of the above report.

Sincerely,

Chuck Dushek

