

# ***Capital Management Associates, Inc.***

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

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## **CMA's Portfolio Holdings & Economic News for Early January**

### **Current Economic & Market Situation**

The economy and financial markets remain in a depressed mood in early 2008 from the ongoing contraction in residential housing construction, high inventory of unsold homes on the resale market, and sluggishness by the Federal Reserve to cut interest rates further. December retail sales were a little weaker than analysts were expecting, whereas a lot of the Xmas sales occurred in November....yet across both Nov & Dec, sales are just modestly higher compared to last year's same period. It seems that lower income households burdened with relatively high mortgage payment commitments and higher energy costs retreated a bit on Xmas shopping.

The major factor that most analysts are worried about, regarding economic growth, is the potential impact from housing slowdown whereby consumers in the sub-prime mortgage class can no longer refinance "cash-out" of home valuation gains, which has been a source of consumption spending from 2003-2007 for the economy. Mortgage rates are cheaper now than at any time during 2007, but lenders now want at least 10-20% down and higher credit scores to grant current 5.25% 15-year rate and current 5.60-5.75% 30-year mortgages. These tighter lending standards and weaker home resale values have created a "log jam" in resale transaction activity...the resale market is in a freeze up. With the FED expected to cut interest rates further, and the US government implementing aid plans to mortgage borrowers such as "rate freezes" and more guarantees on lower quality new mortgage originations, the housing finance credit squeeze will diminish over coming months.

The stock market is behaving like there may be no "sunshine" in terms of a return to normal economic growth for the US in the typical 3-5% annual growth range. It seems that neither analysts, nor economists in general, nor many investors want to "look over" this valley of economic sluggishness due to housing, and invest with the idea that normal economic times will return. Maybe, because of the history in economics over the past 10 years or so, where we have been in turbulent times...tech bubble, internet stock bubble, Iraq war, 9/11 terrorism, \$100 oil, and now the residential mortgage mess....people in general may have lower conviction on the durability of the US economy and its financial system.

The "history" of the US system and economy is that it has weathered and recovered from all past economic and financial system setbacks. The residential housing and mortgage situation is another new setback to overcome. Actions from the FED, US government and private sector adjustments will likely cure this problem in time. Both foreign and domestic capital additions are flowing into major banks, and as the FED cuts rates further, adjustable rate mortgages will likely see smaller future upside adjustments.

The US dollar has recently been steady to slightly lower versus the Euro and Japanese yen, but a bit stronger against the Canadian dollar. This continues to help US export growth and foreign earnings of US companies. Crude oil prices are staying below \$100 per barrel on the

expectation of moderating economic growth in the US and other countries in 2008, which should dampen demand for crude. Moreover, growth of ethanol usage in the US and higher mileage new cars are helping to reduce demand for petro-based fuels.

In summary, any investing that individuals, mutual funds, or money managers do is guided by their outlook or judgment for the future....the outlook of the ones making the investments, not necessarily general market psychology that may be different (usually more pessimistic). It is a valid statistic that nearly 80% of people who own stock mutual funds have only a layman's understanding for making qualified investment decisions; hence they select mutual funds to make stock investing decisions for them. Further, when this class of investors (mostly 401K plan investors) choose to hold cash or fixed income investments, rather than stock mutual funds because of fear or negative anxiety on stocks, great hoards of investible funds remain on the sidelines. It is not until the next upwards bull wave for the stock market is well underway that they return to stock mutual funds from cash...well after a market bottom. There is a lot of negative anxiety on stocks by the public. Currently, this is preventing normal stock market behavior and trending.

Our economic and market view at CMA is that there will be "sunshine" ahead for renewed economic growth, recovery in stock prices, and a normalization of the US mortgage credit system. All of the companies we have selected and are invested in have stable and growthy businesses over the long run, during normal economic and financial market conditions. We believe that normal conditions will return, before 2008 closes its books.

Greg Nickum, CMA's Investment Analyst and Certified Financial Analyst (CFA) is preparing a fresh update on any new material developments on CMA investment holdings that have occurred since year end 2007. He will be sending that out in the next day or two.

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