

Capital Management Associates, Inc.

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

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CMA Investment Update July 30, 2007...An Unsettled Stock Market

General Overview

During the past few weeks, the negative impact of collapsing sub prime residential mortgage securities have caused the stock market to go lower. It was felt that mortgage lending to other than prime borrowers would dry up, causing new home construction to fad and existing homes sales to slow further. These factors in combination could slow the overall US economy as housing is a large industry. If the economy slows, so do earnings growth of many companies, and that causes stocks to retreat in value.

Some other factors that have converged with housing problems to weaken stocks are: very high crude oil prices & gasoline, higher lending costs to borrow money by private equity funds that is slowing company acquisition activity, and concerns that the mortgage securities meltdown could endanger the financial system.

None of these factors are so extreme, in my estimation, to cause any more than limiting the upside of the stock market for this year (I had predicted a total 7-8% upside for the market earlier this year.), yet not severe enough to put stocks into a bear trend. During the late 1990s, there were frequent financial system upsets (Russia bankrupting their debt, A large hedge fund collapse, currency collapses in Asia, 9/11 in 2001..many events that were transitory). This current mortgage market upset will heal itself shortly. The Fed regulators were too lax at overseeing loan underwriting standards, which I believe fed the sub prime underwriting frenzy and flow of bad debt. As usual, the government comes to the rescue with better regs and oversight "after" the horse runs out of the barn.

The month of July was poor for all stocks, but for a very few companies that reported great earnings growth, and absolutely no connection to: outstanding mortgage debt, homebuilding, real estate in general, banking, or had business cycle sensitivity. I believe that only homebuilding and mortgage related industries have a long healing process to go through....we are not in those stocks. Likely, when the healing is over in 6 months or a year, these same sectors where their stocks have been killed today will be the "out performers" on the upside in the market next year.

Investment Strategy Activities & Stock Selections

We have done some common stock buying before and during this recent sell off in July. I am focusing on only "value priced" common stocks and beaten down financial and utility stocks that have high dividend yields in the 4-7% range. Many of these are money center & regional banks, insurance, electric and gas utilities, plus some industrial companies that pay high dividends. I am thinking that with these stocks having come down 15-40% verses the DOW index over the past 6 months, that they have 10-30% upside, plus the dividend yield over the next 12 months.

Theses include: Allstate, AJ Gallagher, Atmos Energy, Bank of America, BB&T Bank, Citigroup, Citizens Communications, Duke Energy, FNB of Penn, Ford, Huntington Bank, Johnson & Johnson, JP Morgan, National City Bank, Newell Rubbermaid, Nicor gas, NiSource, New York Community Bank, Old National Bancorp, Pfizer, Progress Energy, Susquehanna Bank, Valley National bank, Wachovia Bank, Washington Mutual, Wells Fargo, Washington Gas Light. A number of these banks carry higher star ratings by S&P, where they see up to 30% upside in the shares.

In the REIT area(Real Estate Investment Trust companies that own, operate and lease broad portfolios of income real estate in apartments, senior living, nursing home, upscale hotels and industrial properties), there are very attractive share prices and high dividend yields available....even more attractive than what bank stocks are offering. We have built up holdings in REIT shares where shares have tumbled 30-50% and have dividend yields now of 6-11%.

I favor the attractiveness of the long term care REITs and upscale hotel properties since these properties have durable pricing power on rents, barriers to new competition, not cyclical, and property valuation upside. Some of these REITs could come up 50-100% in the next year or two. The income yields are very compelling while we are waiting. These include: Ashford Hospitality, Duke Realty, Healthcare Properties, Health Care REIT, Healthcare Realty Trust, Hospitality Properties, HRPT Properties, LaSalle Hotel Properties, Marriott, Nationwide Health, St. Joe, UDR Apartment Properties. S&P also likes to upside of these selections, being on their most attractive High Yield list now.

The third area of the market that has given good values is in beaten down growth stocks, companies that have durable brand positions, and I feel are emerging from midsize to be larger more successful companies in the next year or two. This group also includes large cap growth companies that had recent disappointments on earnings, and are improving their business models and performance for the future.

These include: AMD, Alaska Air, Amgen, Anheuser Busch, Brinker, Genentech, Harley-Davidson, Hershey, International Game Tech, Lexmark, Borders Books, Chicos FAS, Kohls, Lowes, Motorola, Network Appliance, Office Depot, OfficeMax, Panera Bread, PF Changs, Rite Aid, Saks, Starbucks, USG Corp, Whole Foods, WalMart, Yahoo...drugs...Sanofi-Aventis, GlaxoSmithKline, & Novartis. These stocks have all retreated 20-50% against the major indexes over the past 6 months as many investors have sold them out to buy the high flying oils and growth stocks. I think there is substantial upside in these companies from both an upside recovery in the stock market at large and improvement in each company's fundamentals.

Greg Nickum, CMA's associate portfolio manager, who is a Certified Financial Analyst is monitoring all of our investment holdings daily in his new full time position at CMA. Todd Schultz and wife Dr. Joanna decided to return to Canada and live after waiting for 6 years for US citizenship, that was not granted in the aftermath of 9/11...both their children were born here. Greg having replaced Todd, will be distributing a weekly email update that discusses just the stocks we hold in portfolios about recent developments on these companies. Clients should find Greg's comments insightful from his years at stock analysis.

Please call Greg Nickum or Chuck Dushek to discuss any aspect of your portfolios. From these recent shifts in our portfolio strategy, we are still focused on seeking our 10% minimum return for the year 2007.