Chapin Hill Advisors, Inc. Market Comment
February 1, 2008

The Fed Rides to the Rescue!!

The constant chatter on all the financial shows this past Monday and Tuesday was the guessing game of what would the Fed do? – Lower ¼, ½? Not at all? How the market would react? What does action or inaction on the Fed's part mean for the market? For the economy?

Going in to the FOMC meeting on Tuesday, the seers on Wall Street had a 100% expectation that the Fed would cut rates by a ¼ point and 85% expectation for ½ point. The Fed apparently listened and they did not disappoint – cutting rates by ½% - making that 1.25% in a week!

Initially, there was much hoopla as the markets rallied strongly with the Dow up over 200 points within the hour after the announcement. However, the markets turned around on news that some of the bond insurers may be in trouble and the Dow ended up in negative territory – down almost 40 points on the day. The other averages fell as well.

The volatile market continues to make it very hard to position trades and hard to hold on to positions if you are sensitive to keeping your losses small. The leadership has changed and the stocks which were strong last year – especially techs – are weakest this year. The stocks which took the biggest hits over the last few months are leading – homebuilders and financials – as hopes that a rate cut will magically erase their woes. The stocks are up double digits in days.

Financial companies continue to be under pressure as UBS announced another $14 billion loss – more than anticipated. They supposedly had taken a very aggressive stance last quarter in their write-down's so announcing another big write down makes you wonder where the bottom is on losses. American Express, the credit card of the higher quality consumer, was under pressure this week as they announced an increase in delinquencies and created a larger loan loss provision going forward. This was taken as a sign that the credit crisis is not just affecting the less than credit worthy but reaching up into the middle and upper middle classes.

Eddie Lambert, the wunderkind hedge fund manager who decided he would try his hand at retail management by buying Kmart and then gobbling up Sears, was under scrutiny this week as he was questioned by analysts. The president exited after less than a 2 year stint and supposedly top talent that was courted turned down the opportunity run the company due to Eddie's hands on style (might we say micro-management?). The stock is down almost 50% and many expressed concern over his ability to turn it around in a bad economic environment.

President Bush made an attempt to salvage his image in his address on Monday and both parties made a big deal of pushing through an economic package. The economists and strategists seem divided on whether this will really help and if so, when. The consumer seems to be pulling in their spending and it is a concern for a wide array of retailers. Remember, consumer spending comprises 70% of our GDP (gross domestic product). Compare that to a manufacturer whose largest client is ailing – how is the company going to make up for that loss?

The Senate added some measures to the bill by the end of the week after it passed Congress in the beginning of the week. We will have to see if it gets pushed through quickly with these changes and how fast the IRS will be able to get those checks in the hands of Joe Q Public. Will the average American spend their refunds? Or will they pay down debt or put it into savings? Supposedly that phrase "please spend this" is going to be written right on the check!

The market rallied on Thursday as we had mixed news with ADP payrolls up (good); GDP slowing (bad); consumer confidence down (bad); durable goods up (good); ISM over 50 (good); payrolls down (bad). I believe the markets would have sold off on Friday if not for Microsoft announcing that they made a bid for Yahoo.

Microsoft has a hoard of cash on their balance sheet so when Yahoo reported a weak forecast and lay offs of 1,000 employees on Wednesday, Microsoft swooped in with a buyout bid on Friday morning.

This news drove the markets up across the board. The move up was tempered a bit when payroll numbers were released. If the Microsoft announcement had not been made, it's quite possible the markets would have been down for the day.

As the day progressed, the markets continued the wild swings which have become standard. After running up almost 150 points on the DJIA, by mid-morning the indices returned to just about to their opening prices, swung up and then back down in early afternoon before climbing for the rest of the day.

Earnings season is just about over and the estimates from Wall Street analysts was for a 9% decrease from last year at this time. Instead the numbers were off over 20% - led by the financials which does comprise a large portion of the S&P. \

Gold came off its high of trading in the $950 range to close under $900. Gold generally tends to peak in January. Oil still hovered around $90 a barrel. This week the Wall Street Journal discussed China's voracious appetite for oil and its affect on prices and supply. Currently, China is consuming 10% of the worlds' daily output of oil but their economy is on fire – growing at 11% this past year. So their dependence on oil should continue and they will consumer a greater portion of our worlds' supplies. This is causing a lot of concern in many areas.

It seems pretty clear that the volatility is to remain with us for the foreseeable future. The indices erased part of their losses for the month in the last 7-8 trading days. However, the old adage about the market action in the first month of the year is “as January goes, there goes the year”. So if January is down, the year will end down. Of course, you can add this to the Super Bowl theory (if one league wins, the markets go up and vice versa), the short skirt theory (the higher the skirts in the spring season the higher the market rises), etc. All of these theories work – sometimes. They are more fun than anything else. So don’t bet the ranch on any one “rule of thumb”.

By mid January, we were back to August 2006 levels in most indices. If the markets fall to the level some strategists are predicting (1086 S&P and 10,000 DJIA), we will be back to mid 2004 levels. Now that would make a lot of people nervous as they see their nest eggs fall after their homes have declined in value – the two prongs of their precious retirement savings.

We are likely to get a bit more of a rally in the next few weeks but we do not think this is sustainable. So, if you learned any lessons in the last few weeks about how much exposure you have to weaker sectors or how much more volatility there is in your portfolio – use this rally to unweight the weaker sectors, stocks, asset classes where you are exposed.

Even if the Fed and government stimulus plans work and people go out and spend, spend, spend those tax refunds and use lower rates to buy that dream home or load up on inventory in their business, we are a long way from being back to “okay”. We have a soft economy, too much debt, a long running, expensive war in Iraq, slowing consumer spending and house prices still falling and inventory building.

Button up your plans, be sure your spending is within your budget, make sure you are saving, be prepared for emergencies and have a contingency plan if you are laid off. If one or more of you is relying on a real estate market for income, re-think that unless you are very experienced and have a great network or are in a prime area. Some parts of the country such as Cleveland, Detroit and Denver are in dire straits. Next issue is the tax base eroding as homes foreclose and we lose that revenue. Many of us pay very high school and property taxes so how much more of an increase are we willing to assume before looking for greener pastures?

Feel free to call us with questions and comments and please forward this to your colleagues and friends if they are interested. We offer complimentary meetings to review objectives and portfolios and our best clients come from referrals!