

Chapin Hill Advisors, Inc.
Market Comment 4-28-08

Seventh Inning Stretch?...Or Second Inning?

Wall Street loves baseball analogies so many of the seers are using are baseball talk to tell us the worst of the credit crunch and bad news is behind us and we are in the 7th or 8th inning, almost to the end game. Lloyd Blankstein – CEO of Goldman Sachs, legendary investor Warren Buffet and Bill Miller – manager of the Legg Mason Value fund, have each publicly made a proclamation along these lines.

However, other analysts and noted investors do not share their optimism and believe we are closer to the 2nd inning rather than the finish line. They believe the 14 year credit expansion will take years to unwind and we will not see the end of this cycle until 2009 -2010. Most seem to agree that we need to see housing prices level off and for sales to stop declining before we are near the end.

This weekend's Barron's quoted Jay and David Levy, who produce the Levy Forecast, voicing a dismal view that the worst is yet to come. They feel it is too early for bottom fishing for bargains in the market and the bottom will only come after a deep recession with continued declines in employment, falling commodity prices and general global financial and economic turmoil. Not a welcome forecast for most of us!

The weekend edition of the Wall Street Journal included an interview with 89-year-old Peter Bernstein who has witnessed every financial crisis in the last century. As a boy, he watched as his father managed money through the Great Depression. As an adult, he managed money and is considered a market historian with several books to his credit.

Mr. Bernstein's view is that the current crisis is the worst since the Depression and over-borrowing by financial institutions and consumers as well as the securitization of a large amount of the loans made by banks will take years to unwind. He views the current business cycle recovery as a "U" with a very long bottom rather than the more common "V" recovery typical of many past cycles. He feels that the reduction in risk by banks will continue to cause credit to tighten which will hamper growth. We see this happening in the housing market as institutions raise the bar whether it is via credit scores, increased down-payments or both for home buyers.

Goldman Sachs latest strategy report was sobering as well. They believe we will see a compression of earnings, lowering PE's by 15%, weakness in consumer spending well into 2009, 10% declines in housing prices in 2008 and another 5% in 2009 and a possibility of 1150-1200 on the S&P (currently at 1401). They caution that bear market rallies masquerade as market bottoms.

The write-offs continue to add up as Merrill, Citi and others took massive further write-downs. UBS declared \$38 billion of losses and are scaling back their investment banking. Rumors abound on forced spin-offs of at least one of their divisions to raise cash and attempt to cut risk. Speculation as to whether it will be investment banking, their broad wealth management business (keeping private banking) or asset management divisions to get the boot is rampant.

The Fed meets this week and the consensus is for a cut and a pause. Most expect the Fed to cut another 25 basis points (0.25%) and stop there. The Fed is concerned about inflation. The government continues to tell us that inflation is running at less than 3% - a big increase from past years but much lower than what most consumers are experiencing in their everyday lives.

The government is our biggest employer and salaries are increased with CPI (consumer price index) as the benchmark. Social Security payments are also benchmarked to the CPI. Therefore, the government has quite an incentive to contain the CPI. They changed the way they calculate inflation back in the early 80's and many experts take issue with their calculations.

One man, John Williams, publishes an electronic newsletter called Shadow Government Statistics and in this he provides inflation calculated using the pre-1980's revisions. Calculating inflation this way gives us an 11.6% increase year over year – almost four times what the government is telling us! This number certainly seems to be more in line with the increases consumers are experiencing in their home heating bills, the price at the pump, increase in eggs, milk, meat and corn, etc.

Oil continues to hit new highs, making a new record at almost \$120 a barrel on Friday. The average price at the pump is \$3.51 and expected to rise to \$4.00 a gallon over the summer. Airlines are getting squeezed by higher gas prices as well and at least two – Northwest and Delta – are planning on combining to help create synergy, control costs and increase passenger traffic. This summer's vacation plans are supposed to be abbreviated as consumers feel the pinch of higher gas prices and continued declines in housing and work to scale back travel plans.

Housing news continue to weigh on the market. New home starts declined 8.5% - the slowest since December 1991. The Michigan Consumer Sentiment number reflected this pessimism as the number released on Friday morning was the lowest since 1982.

Throughout this pessimistic environment, the markets have been trying to rally. They fought off bad news on Friday morning to end the week up for most indices. While still down year to date, most of the indices have improved over the past 4-6 weeks. We are still in a trading range and the S&P needs to break 1410-1415 before going higher. It could hit 1500 on a rally – a gain of 7% from these levels.

Our belief is that we are in an intermediate rally in the confines of a bear market. So don't get overly optimistic and throw caution to the wind. This rally, if it happens, will most likely lift the most beaten down industries and stocks – such as financials, homebuilders, commercial real estate and retailers. It is likely to be short lived before another sell-off takes the markets below February lows. The old adage “Sell in May and go Away” may indeed be the one to follow this year.

If we are right, you may want to use any rally to get out of stocks that have questionable future earnings streams, those in which you have concentrated positions and possibly those stocks or sectors which dragged your portfolio down in January and February. Do not act emotionally. Pick your exit prices and stick with them. Technical analysis is a good tool to use in figuring out resistance levels to analyze what prices stocks may trade back up to and then pause or begin to fall again.

Be sure you have a diversified portfolio but be careful not to chase return by buying after rallies have taken place and “everyone” is talking about the sector (ie commodities). Remember that the first decline during the bear market which included the Great Depression is not the one that really wiped out net-worth. It was the decline after the first rally when investors thought it was safe to get back in to stocks and the following swift decline (which lasted years) is the decline that pushed investors over the edge.

This is a great time to sit down and draft a formal financial plan if you have not done so. Knowing how much is enough, what type of return you really need to maintain in your portfolio to provide for your financial objectives and including inflation's effect on your goals is critical and can bring you peace of mind knowing you have a game plan and a path toward financial security.

As always, feel free to call us with questions or comments.

Who is Chapin Hill?

Chapin Hill Advisors, Inc. is a boutique financial planning and investment advisory firm, providing our services to high net worth individuals or business owners. We use the full range of investment products and employ a core and satellite strategy to better facilitate the implementation of specific strategies.

We pride ourselves on the delivery of great service. Our delivery of service is customized to the clients needs and includes quarterly reviews as well as regular communication based on what you desire.

The Chapin Hill Advantage

A unique, process-driven approach to financial advice that combines expert financial knowledge with high-touch service, resulting in a personal investment strategy that leaves clients feeling confident and having “peace-of-mind”. We take the time to understand you prior to making any recommendations. Our planning process covers *The Seven Tenets of Planning*: retirement, education funding, risk management, cash flow/debt management, taxation, estate planning and investment management. Our

process can determine your probabilities of success based on the most appealing scenario of your choice.

The Chapin Hill Advantage was created by our founder Kathy Boyle. She has over 15 years' experience within national and regional investment banking and brokerage firms prior to founding Chapin Hill in 2000. Kathy is a regular commentator and guest on national television shows such as **CNBC's Power Lunch**, **NBC's Nightly Business News**, **ABC's Businessweek TV**, **Fox's Your World with Cavuto** and **Bloomberg** radio and personal-finance shows.

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