

Chapin Hill Advisors, Inc. Market Comment
March 26, 2007

Lower Rates from the Fed? Be Careful What you Wish for...

Last week's market rally was fueled by speculation that the Fed is finished raising rates are they paused for the 6th time in a row. They indicated that they were concerned about inflation but also concerned about the housing markets effect on the economy. This was translated as a reason to celebrate and it triggered a third day of rallying across most indices.

For the week, the Nasdaq was up 3.5% as was the S&P 500. The Dow was up 3.1% and the S&P 600 was up 4.19%. Most indices were now in positive territory for the year. Thursday and Friday trading was rather dull with little movement and light volume on most exchanges.

If you stop to think about it – do we really want the Fed to lower rates? If they lower rates, it means our economy is slowing and the Fed needs to release more liquidity into the marketplace to prop up growth. If growth slows, then earnings estimates will be reduced and very quickly, stocks which sported “reasonable valuations” quickly become overpriced. Overpriced stocks tend to fall.

The Fed did mention concern about inflation and Philly Fed President, Charles Plosser, spoke out about concern that inflation was not abating and there was the need for the Fed to remain vigilant. Stagflation is beginning to pop up again as a concern (slowing growth with rising inflation is in its simplest term).

Blackstone Group, the huge and very successful private equity group, announced that they are indeed filing a \$4 billion IPO. This is likely to be followed by others private equity shops with Fortress being rumored as the next one to announce. Is Blackstone seeking to cash out at the top? Or does this provide them with more liquidity for future deals without having to chase down pension funds in a highly competitive landscape? Only time will tell.

We have had 3 days of housing numbers and most of it is not rosy. February home sales jumped 3.9%, the best gain in nearly 3 years. Northeast sales surged as warmer temps in January fueled closings in February. But homes for sale shot up 5.9% and median prices declined. On Monday morning, new home sales were released and they fell 3.9% - quite a big difference from the Wall Street estimate of a rise of 7%. The current inventory of homes across the nation would take over 8.1 months to reduce through regular sales volume.

These numbers did shock the markets and by midday Monday, most of the major markets were off by ½%. An analyst interviewed on CNBC said that historically employment follows new home starts by about 12-15 months. Since new home starts have been declining for most of the past year, if history holds true, we would expect to have weakening in employment. Also, remember that a large

portion of recent job creation over the past 4 years, some estimate as much as 60%, is related to housing.

The sub-prime fallout got a bit of relief last week as some buyers swooped in to pick up inventory at reduced prices and make loans to Accredited Home Lenders. Barrons' interviewed Sy Jacobs this weekend and he anticipated the problems in the sub-prime arena as early as 2005. He feels the continuing problems in this area will worsen and housing is just getting started on the downside. He mentioned that the most popular loan product in 2004 (when financing volume in the prime market peaked) was a 3/1 adjustable rate mortgage. This means the rate is locked in for 3 years and then adjusts yearly after that. After 17 quarter-point increases in the fed-funds rates, these resets are going to hit people hard as their 3 year anniversary arrives in 2007.

Another Barrons' interview was with Yale's economist, Robert Shiller, the author of *Irrational Exuberance*. He garnered fame for predicting the impending stock bear market in March 2000. He is predicting a 20-30% decline in nominal home prices over the next 5-10 years. Shiller notes that home prices historically have traced multi-year trends up or down. The blast off from 1996-2005 was the biggest housing boom in history. He says that prices are so far above construction costs that it cannot persist for long. He believes that people will move to areas with lower housing costs when prices become elevated in hot areas. That trend would coincide with the baby boomer approaching an age when they can move to lower cost areas as they near retirement. Shiller is predicting a decline even in markets like San Francisco and New York which have a paucity of land and severe zoning restrictions and many argue will maintain their prices.

The beauty of our core/satellite investment strategy is that when the market trends up, we will capture that return in our core portfolios. These are traditional portfolio models which are designed to meet our clients' overall objectives but also meet their downside risk tolerance. Depending on the client's risk tolerance and objectives, we will generally have an asset allocation of anywhere from 19% to 60% exposure to equities.

Our satellite accounts took it on the chin last week as we are bearish in most of these models. However, if we are correct in anticipating significant downside potential in the markets, our satellites will capitalize on this downside movement. Our goal is to protect our clients' overall portfolio as we seek to have non correlated performance with our core models. We are anticipating the possibility of a 15-20% downside in domestic markets and possibly as much as 30-40% in international and emerging markets. We do not know how long this will take but we do believe we are in the beginning stages of a bear cycle. No market goes straight up or straight down. So use opportunities like last week's rally to be sure you have some means of protection in your portfolio should the markets decline over the next 6 months to one year.

As always, feel free to call us with questions or comments. Please feel free to pass this market comment along to your peers and friends.

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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