Delta Financial Advisors

August 2008

Economic Comments

While the Federal Reserve's rate setting committee did not meet in July, Chairman Bernanke provided his share of surprises when he suggested mid month that the Fed's immediate focus is to stabilize financial markets rather than to reign in inflationary pressures. Pushing him in this direction have been the continued issues in the financial sector as highlighted by the government led rescue plan for mortgage behemoths Fannie Mae and Freddie Mac.

Unfortunately, the challenges in the housing market do not seem to be abating yet. To get a general feel on the state of the housing market, we could look at the relative price of housing by examining its closest alternative, renting a house. In the twenty years leading up to 2002, the average American home sold for about 14 times the annual rent of a comparable house. By early 2006, this ratio had rocketed to 25 times the price of a comparable rental. While this ratio has now declined to around 20 in most markets, it is still meaningfully above the recent pre-bubble norm which suggests that there is additional room for further housing price declines.

The housing market continued to deflate as sales of existing homes fell by more than 2.5% in June. Current housing inventory is now equal to an 11 month supply (at current sales rates) – the second highest level seen in the last 25 years. Levels continued to be pushed higher in the face of the ongoing tsunami of mortgage foreclosures.

As for economic data, the reported inflation rate for June remained elevated with the CPI measuring monthly inflation of 1.1%, sharply ahead of expectations. However, the core CPI data was much more muted at 0.3%. The sharp discrepancy remains driven by soaring energy and food prices. Looking forward, non core inflation pressures should recede in the face of the recent decline in energy prices.

Tentative readings for the 2nd quarter's economic growth appear to be relatively strong when adjusting for the credit and housing market issues. The U.S. Commerce Department now estimates that the nation's economy grew by 1.9 percent for quarter ended June 30. While lower than most estimates, the quarter's growth was remarkably strong in the face of rising energy prices and difficult credit markets. U.S. exports remained a key component to the growth which was further helped by resurgent consumer demand driven by Federal tax rebate checks.

While the overall inflation picture remains dim, a silver lining exists in the weak employment market where unemployment has now increased to 5.5%. As real wages are currently declining and unemployment increasing, there is limited leverage to create an inflationary wage spiral. While energy and food prices are growing, core inflation has edged down as consumers re-allocate their finite pool of funds to buying gas and groceries.

While beneath expectations, labor productivity remained robust with non farm workers increasing their efficiency by 2.2% in the 2nd quarter. This reading was above historical norms and is a harbinger of increasing personal wealth for Americans. Volatile durable goods orders showed surprising strength in June as they climbed by almost 1% instead of declining as had been widely expected. Highlighting the challenging economic environment, orders for durable goods have climbed only 3 out of the past 6 months.

The ongoing credit crunch remains a continued drag on the economy. Emblematic of the continued issues was the abrupt failure and seizure of IndyMac Bancorp by the Federal Deposit Insurance Corporation mid month. Just several months ago, the bank had not even been on regulators' radar screen for being troubled.

The U.S. economy continues to expand. Yet between a depreciating housing stock, reduced employment prospects and higher inflation, many are feeling economic strains. While not yet in recession, the current situation feels gloomy. While seriously concerned about the Federal Reserve's increasingly interventionist actions, we believe that a recession may yet be averted. However even in the event of a recession, we do not believe that this recession will be the cataclysm that some doomsayers anticipate, but rather that it would be a period of re-grouping before the economy resumes its long-term course of expansion.

Market Comments

The most surprising event of the market's month was the Treasury and Federal Reserve stepping in to bail out the twin pillars of the U.S. housing market, Freddie Mac and Fannie Mae. While the two firms were long believed to have implicit backing of the U.S. Federal government, this belief had never before been tested. In the face of increasing market panic, the government gave the

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Performance as of 07/31/08

	Close	Month	YTD	1 Year
DJIA	11378.02	+0.43%	-13.00%	-11.71%
S & P 500	1267.38	-0.84%	-12.65%	-11.09%
NASDAQ Comp.	2325.55	+1.42%	-12.30%	-8.66%

	Month end yld.	Prior Yr. end yld.	12 mo. prior yld.
10 yr. U.S. Treasury	3.98%	4.03%	4.77%

two mortgage giants access to the Treasury's discount window (i.e. access to borrowing money) and promised to inject additional capital into the companies if needed.

After falling sharply in the face of the near deaths of Fannie and Freddie, the broader markets surged by almost 5% from their mid month lows as commodity prices showed sharp drops. Oil peaked mid month at levels of almost $145/barrel before falling almost 15% to finish the month sharply lower.

Although having recovered from its mid month lows, the market officially entered bear market territory (i.e. a 20% decline from October highs) on July 9th. Looking at bear markets historically, the average bear market lasts 406 days during which period stocks incur losses of 31%. Using this historical activity as a rough benchmark, we would now be more than half way through the current bear market. However with financial and consumer discretionary stocks typically leading the way in a market recovery, these two sectors continue to struggle.

The current market ills continue to be largely dictated by the ongoing credit crisis. Expectations for additional bank losses of at least $600 billion are layered on top of already realized losses of roughly $400 billion. Over 70% of banks, according to a recent survey, have been responding to this environment by recently tightening lending standards.

2nd quarter earnings were unable to provide much cheer as corporate earnings fell by 22% on the back of continued and sharp losses in the financial sector. In the face of the dismal 2nd quarter earnings, analysts now expect full year earnings to show a more modest 6.4% growth. The key to achieving these more modest expectations, however, is very robust 3rd and 4th quarter earnings. At this stage, we are less confident of this likelihood given the continued drama from the financial and housing sectors.

Probably one of the most important things that we can share with you is the importance of keeping the current market downdraft in perspective and not to panic. While painful, the current downturn is a normal part of the market. With a properly diversified portfolio and a clearly articulated investment plan, your long term objectives should remain unimpaired by this recent down turn.

Analyst Corner

We have been looking at an interesting firm recently, The Manitowoc Company (*NYSE-MTW*). The firm is one of the world's largest makers of heavy cranes and excavators used in large scale infrastructural work. In recent years, the company's operations have expanded sharply in the face of the strong demand for its products by rapidly expanding overseas economies.

While we are impressed with its core competencies, the company is not without risk. Its end markets are typically cyclical and we are now seeing what are likely to be peak cycle earnings. Moreover, the company is in the process of transformative acquisition that will sharply leverage Manitowoc's strong balance sheet. As a result, Manitowoc is definitely a more risky proposition. Nonetheless, for a more aggressive investor, this stock could be an attractive addition to their portfolio.

Planning Thoughts

Today's society is far more mobile than 100 years ago. Whether the result of frequent moves or incomplete record keeping, it is increasingly easy to lose track of small assets such as utility deposits or dividend checks.

We recently had cause to check an unclaimed property list and decided to see if any other clients were on this list. To our surprise, there were a large number of clients indicated as having unclaimed property. As a result, we will be contacting a number of you over the coming days with a lead on collecting some lost funds. While the funds are small, typically beneath $100, every dollar helps!!

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