Delta Financial Advisors

February 2008

Economic Comments

In recent weeks the Federal Reserve has made it very clear that it is extremely concerned about the economy. In two separate moves in January, the Federal Reserve cut over-night interest rates by a combined total of 1¼ percentage points. Their first step was taken on January 22 when the Fed in an unscheduled meeting reduced rates by 0.75 percentage points. Largely driving this decision was the continued weakening of the economy coupled with the continued turmoil in the broader financial and credit markets.

Chairman Bernanke and the other members of the FOMC then followed up this meeting with their regularly scheduled meeting of January 30th where over-night rates were again reduced, this time by 0.5 percentage points to their current level of 3.0 percent. Clearly, not very much had changed in 8 days (as the impact of rate cuts typically take 9+ months to flow through the economy), yet the Federal Reserve felt compelled to act again.

Unfortunately, in our opinion, Chairman Bernanke's focus has been overly single minded as he has been focused on economic growth while ignoring resurgent inflation. A sop in this direction was put forward following the January end meeting where the Federal Reserve indicated that it "expects inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully."

To step back, the Federal Reserve is clearly focusing on its objective of maximizing employment to the detriment of stable prices, i.e. inflation. Furthermore, whether by intent or not, Chairman Bernanke is acting to save those individuals who created much of the recent financial excesses driving the current credit market problems.

Our lawmakers have also made it clear that they too are concerned about the economy. As the month closed, Congress was finalizing a tax rebate package that would effectively return $150 billion via tax rebate checks to those tax-payers making less than $75,000 each. Of course this being Congress, other more timely means of stimulating the economy such as increasing unemployment benefits or increasing food stamp benefits were ignored. Nonetheless, this action will eventually show some small level of economic stimulation at the cost of only $150 billion to our children and grandchildren.

While by no means great, recent economic data was not as dire as the Fed's frenetic actions would suggest. 17,000 jobs were lost in January, the first payroll reduction in over 4 years and a potential foreshadowing of imminent recession. However, December's initially anemic jobs report was revised upwards to a more reasonable addition of 82,000 jobs. Despite the month's job loss, unemployment declined slightly to 4.9%.

Another negative data point was the rise of average hourly wages by 3.7% for all of 2007, which lagged behind the recent pace of inflation. Yet despite the recent bad economic news, American consumers became more confident about the economy as confidence readings from the University of Michigan showed meaningful increases. Furthermore, last month's poor manufacturing survey, by the Institute for Supply Management, turned around for January indicating that the sector continued to expand, as opposed to survey's December reading which showed the sector to be shrinking.

In addition, labor productivity growth of 1.8% was ahead of expectations and consistent with longer-term growth rates. Even though labor costs were up 2+% for the prior quarter, the increase was more restrained than most had anticipated.

Basically, we are trying to indicate that despite the image painted by the mass media, there remains some good economic news out there. Clearly the economy is far weaker than it was just several months ago. Additionally, the likelihood of recession has increased. Despite this, we continue to hold to our belief that if the economy does slip into recession, this event should be relatively mild and short in duration. While not something to be eagerly anticipated, neither is a recession a doomsday scenario.

Market Comments

Finally, the financial markets are clearly worried about the economy as the broader markets declined by almost 13.5% during the month before recovering to close out the month down 6.0%. Leading the markets decline were the energy and information technology sectors. The financial sector was the month's best performing with a slight loss, 0.6%, as investors' pessimism for the sector lightened.

During the same period, investors continued their flight to quality with Treasury prices moving upwards as bond yields moved down meaningfully.

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Performance as of 01/31/08

	Close	Month	1 Year
DJIA	*12650.36*	*-4.49%*	*2.55%*
S & P 500	*1378.55*	*-6.00%*	*-2.31%*
NASDAQ Comp.	*2389.86*	*-9.89%*	*-3.00%*
	Month end yld.	**Prior Yr. yld.**	
10 yr. U.S. Treasury	*3.64%*	*4.83%*	

Yields on 10-year Treasury securities hit their lowest level in over 4½ years as investors clamored for the security of United States backed debt.

Corporate earnings for the last quarter, outside of the financial sector, appear to have been fairly robust. Non-financial companies' earnings were up 11% for the year's final quarter. However, total corporate earnings declined by a dismal 19.3% – driven by the enormous brokerage and bank write-downs for bad mortgages.

Looking forward, earnings expectations for 2008 are strong with expectations of 16% earnings growth for the year. Starting out slow, earnings growth are anticipated to sharply accelerate in the latter half of the year as easier year-over-year comparisons become available.

We are not convinced that earnings growth will be as strong as currently anticipated BUT with the S&P 500 trading at a meaningful discount to its average over the last 20 years, we believe that stocks remain an attractive value.

While bonds at current interest levels are not as attractively valued as stocks, they do offer critical portfolio risk reduction.

Given the market's recent turbulence we believe a risk appropriate portfolio remains even more important than ever. If you feel that changes in your needs and/or objectives necessitate a change in your investment policy, please follow up with us so that we can assess any needed changes.

Analyst Corner

We wanted to spend a moment re-visiting a company we recently started buying, Automatic Data Processing, *NYSE: ADP*. Since we first discussed the company in our August 2007 letter, the stock has declined almost 20%.

What has the company done wrong in the intervening period? Not much as its earnings have exceeded expectations in the past 2 quarters. Currently, ADP also expects to have another year of robust double digit earnings growth. What has changed is investor confidence.

The reason that we wanted to highlight this issue is to emphasize that in the near-term stock values can change based on outside events although over the longer-term, companies are valued based on their own economic performance. We continue to believe that holding Automatic Data Processing will be a profitable addition to appropriate client portfolios.

Planning Thoughts

Regrettably, tax season is now close upon us. As you are working to determine your tax obligation, please keep in mind the benefits of contributing to Individual Retirement Accounts. We remain big fans of these accounts as they allow for tax deferred or tax exempt growth over long periods of time.

Unfortunately, access to Roth IRAs phases out above income levels of $156,000 for couples but there are no income limitations for contributions to Traditional IRAs. All IRAs allow for contributions of $4,000 per individual for tax year 2007 and $5,000 per individual for tax year 2008. If you are age 50 or older, an additional $1,000 can be added to your contribution.

We encourage you to make your contribution for 2008 as soon as possible to start having your money work tax free/deferred. If you have any questions about these types of accounts, please do not hesitate to call us.

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