THE SWEETWATER PERSPECTIVE

Our Views on Investing & the Economy **April 2007**

Fear not! Market pundits are telling us the US stock market is too high and a significant pullback is imminent. There will come a time for cautiousness, but now is not that time. Many investors were faked out by the market in late February when the Dow dropped more than 400 points in one day. Global equities got slammed when the Chinese government stated they wanted to curb economic growth. While equity markets around the globe were rattled, the event was just a minor blip in an ongoing bull market.

Why do we remain so positive? Consider the overall stage on which we play. As always, the fundamental forces of supply and demand are at play. In the big picture, record levels of private equity deals (many of which are "absorbing" publicly held companies) and company stock repurchases are reducing the supply of public equity. Contrast this to 1999 and 2000 when massive numbers of initial public offerings (IPOs) were creating more and more stock. In our view, the supply/demand imbalance clearly favors equity investments in today's environment.

Individual investors are still sitting on trillions

Let's discuss a few psychological aspects and some fundamentals regarding the current market environment. First, one of the biggest influences on the market is the financial media. We continue to see and hear the media push a predominately bearish view. Somehow, it seems "prudent" to be bearish and negative, while an optimistic outlook can appear lackadaisical. Interestingly, history reveals that the market has only had three major bear markets in the past 100 years. Therefore, we can infer that major bear markets are rare. Simply put, bad news sells far better than good news, and negativity is generally in fashion. Next, as reported by three of the premier discount brokerage firms (TD Ameritrade, E*Trade and Charles Schwab), interest from the "retail" investor has waned and trading volume has dried up.

Finally, Key Bank, a leading internet bank, recently stated that "We've seen a remarkable surge for CDs this year." *The takeaway here is that individual investors are still holding trillions in cash*. An environment with so much fuel on the sidelines *is not* what you see at market tops. The opposite is true. Most market tops are marked by rampant speculation on the part of investors and high levels of borrowed money (i.e. margin money). This is not what we see today. History says that investors will pile back into the market as it climbs higher. The fear of missing the next move overcomes the fear of losses. We expect this scenario to play out as the year progresses, benefiting those already in the market.

Our All Seasons Strategy has preformed well during this intrepid environment. Allocations to defensive positions with low correlations to the market, such as Master Limited Partnerships, Market Neutral investments and high grade bonds, steadied the portfolio during the "China scare." In our view, the strategy is well balanced between risk and reward. While this approach might under-perform slightly in a 1990s style "melt up," we'll take that chance in order to protect capital if the bear should raise its ugly head.

Wrapping things up, the first quarter generally yielded gains for SFA portfolios *as the stock market remained essentially flat*. Rest assured, there will be more market corrections and we remain on the lookout for the next potential pitfall.

I invite you to call to discuss matters related to managing and growing your wealth.

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