THE SWEETWATER PERSPECTIVE

Our Views on Investing & the Economy

November 2007

Rough sledding – Saying that the market has been volatile lately is an understatement. However, we think the uptrend remains in place. Let's look at what has transpired over the past few months. In mid July, the Dow had surged to an all time high, and was up more than 12% in the first 6-1/2 months of 2007. Experience tells us that stocks, real estate, commodities (and every other asset class) do not appreciate in a straight line. Corrections are inevitable. When an asset class climbs that high, that fast, a pullback is inevitable. The trigger this time was fear surrounding the sub prime credit crisis.

In general, the sub prime crisis is a legitimate concern. However, we don't believe that the problems in the financial sector will spill over into the *entire* economy. Fortunately, with crisis often comes opportunity. One area that has experienced unmerited selling pressure is the energy infrastructure Master Limited Partnerships (MLPs). These businesses have nothing to do with mortgage loans. However, short sighted investors sold these investments to raise cash over the past few months in an effort to meet lending obligations for other poorer quality (read high risk) investments. Many of these gunslingers buy assets with tremendous leverage/debt. Ironically, while these weak holders were selling, company founders and management were buying at record levels.

Regarding market drops, a question we are often asked is, "If it looks like there's a correction on the horizon, why don't you sell and get back in later?" This is easier said than done. Our view is that if we are bullish longer-term (12 months), we won't attempt to "time" the market. Our strategy is tactical, in that we underweight and overweight certain asset classes as we see opportunity. This approach attempts to mitigate risk by employing multiple, non-correlated asset classes to build a diversified portfolio, rather than trying to pick tops and bottoms.

Another question we're asked - "What would cause you to turn bearish?" Although we've been optimistic, we won't hesitate to batten down the hatches if our indicators turn negative. Currently, we believe the fundamental foundation remains attractive for higher equity prices. The US economy is slowing, but there are plenty of reasons to stay invested. Here are a few concrete reasons supporting our optimism.

- interest rates remain low, which is pro business
- corporate profits are strong (ex financial companies)
- yields from bonds and CDs remain low
- effectively full employment – 95.3%

The Global Economy - Around the world, economic growth remains strong. Just 20 years ago, the US accounted for 50% of global Gross Domestic Product (GDP); today it's 33% due to the sizzle in developing countries. I'm reminded of what Yogi Berra said… "The future ain't what it used to be." It *used to be* that the US pulled the world's economy along. Not so anymore. We continue to capitalize on the global growth theme through investments in energy, industrial metals, gold and chemicals. This diverse basket of commodities has been one of many contributors to portfolio gains this year. Energy investments in general and oil services specifically, have been on fire. We'll remain positive on the group until we see signs of slowdown in places like China, India and Brazil.

Here at Home - Domestically, uncertainty continues to mount around the banks, mortgage companies, home builders and brokerage stocks due to the mortgage meltdown. We are steering clear of this sector with the exception of our "special situation" investment in Goldman Sachs (GS). Over the years, GS has shown an uncanny ability to navigate through troubled waters. We think GS will once again set itself apart in the midst of the current market turmoil.

$100 Oil? - The last topic I want to discuss is record oil prices. There is an old saying, "one man's misery is another man's gain." I'm sorry it costs $75 to fill your tank, but our energy related investments have been very profitable. World supply/demand fundamentals combined with geopolitical unrest are the two primary reasons. We see more of the same ahead.

In closing, as bad as the sub prime crisis is (don't be surprised to see more pain in the future), we believe the economy will absorb this mess and stay out of a recession *in the short run*.

P.S. Please feel free to send a copy of this letter to your family and friends. Our business is built on your influence. ♦ © SFA 2007

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