

Monthly Chartbook

August 2007

So much for global liquidity,
risk comes home to roost.

Big time!

If we said it once to clients over the last twenty months we said it 1,000 times, risk is under-priced.

Macro-economic research



Bam! Just look at risk getting re-priced late in July. Fast and loose funny money is starting to dry up now that some things have gone bust. Beware!

Macro-economic research



The VIX was low because of low risk spreads in the credit market, not vice versa.
Volatility has been nowhere to be found until the past couple of weeks.

Macro-economic research

- 1) BN 12:25 Indymac to Make 'Major Changes' to Mortgage Lending After Slump
- 2) BN 12:09 *INDYMAC SAYS FANNIE MAE, FREDDIE MAC PROMISE HELP TO INDUSTRY
- 3) BN 12:09 *INDYMAC SEES NO THREAT TO COMPANY'S SOLVENCY :IND US, FNM US
- 4) BN 12:09 *INDYMAC CEO E-MAIL CONFIRMED BY SPOKESMAN GROVE NICHOLS
- 5) BN 12:08 *INDYMAC SAYS DISRUPTION 'BROADER AND MORE SERIOUS' THAN PAST
- 6) BN 12:08 *INDYMAC CEO CALLS MORTGAGE MARKETS 'PANICKED AND ILLIQUID'
- 7) BN 12:08 *INDYMAC CEO SAYS AAA PRIVATE MBS BONDS ARE DIFFICULT TO TRADE
- 8) BN 12:08 *INDYMAC CEO MAKES COMMENTS IN E-MAIL TO EMPLOYEES :IND US
- 9) BN 12:08 *INDYMAC TO CUT BACK ON SOME TYPES OF HOME MORTGAGES, CEO SAYS
- 10) @ BN 9:16 NYSE 'Threshold' Securities for Aug. 1 (Table)
- 11) BN 8:33 American Home Ends Loans; GE, CIT Seek Exit: Subprime Scorecard
- 12) @ BN 8/01+ Subprime Defaults Blamed for U.S. Earnings Setbacks (Update3)
- 13) @ BN 8/01 Subprime Defaults Blamed for U.S. Earnings Setbacks (Correct)
- 14) @ BN 8/01 NYSE 'Threshold' Securities for July 31 (Table)
- 15) @ BN 8/01 Subprime Defaults Blamed for Corporate America Earning Setbacks
- 16) BN 7/31+ IndyMac's Net Falls 57 Percent as Defaults Surge (Update8)
- 17) BN 7/31+ IndyMac's Net Falls; Shares Surge on Credit Strength (Update6)
- 18) BN 7/31 Faro, Fresh Del Monte, IndyMac, Midwest Air: U.S. Equity Movers
- 19) BN 7/31 *INDYMAC'S DIVIDEND RATIO CURRENTLY ABOUT 90% OF EARNINGS
- 20) BN 7/31 *INDYMAC WILL HAVE TO CUT DIVIDEND IF EARNINGS DON'T RECOVER

Are we having fun yet?

Risk is being re-priced...how long will it take to wash out? More than a handful of trading days, less than _____

Macro-economic research



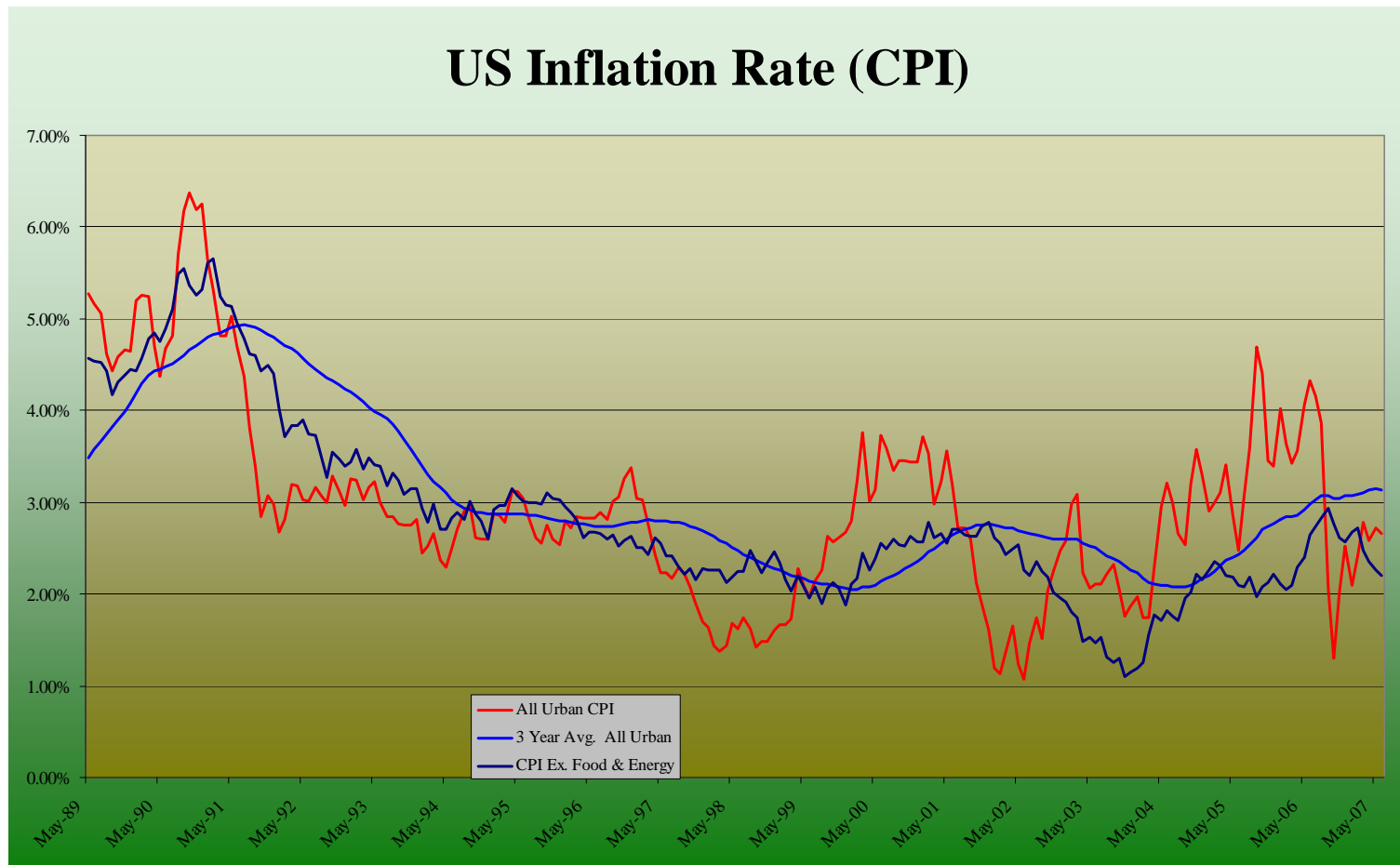
Look at Goldman swoon. They were the high priests of the loose-money nuttiness.
Wow, that stock price is down like \$40 is just a couple of weeks.

Inflation expectations

Food and energy costs have bled into the so-called core rate of inflation, next stop...wages.

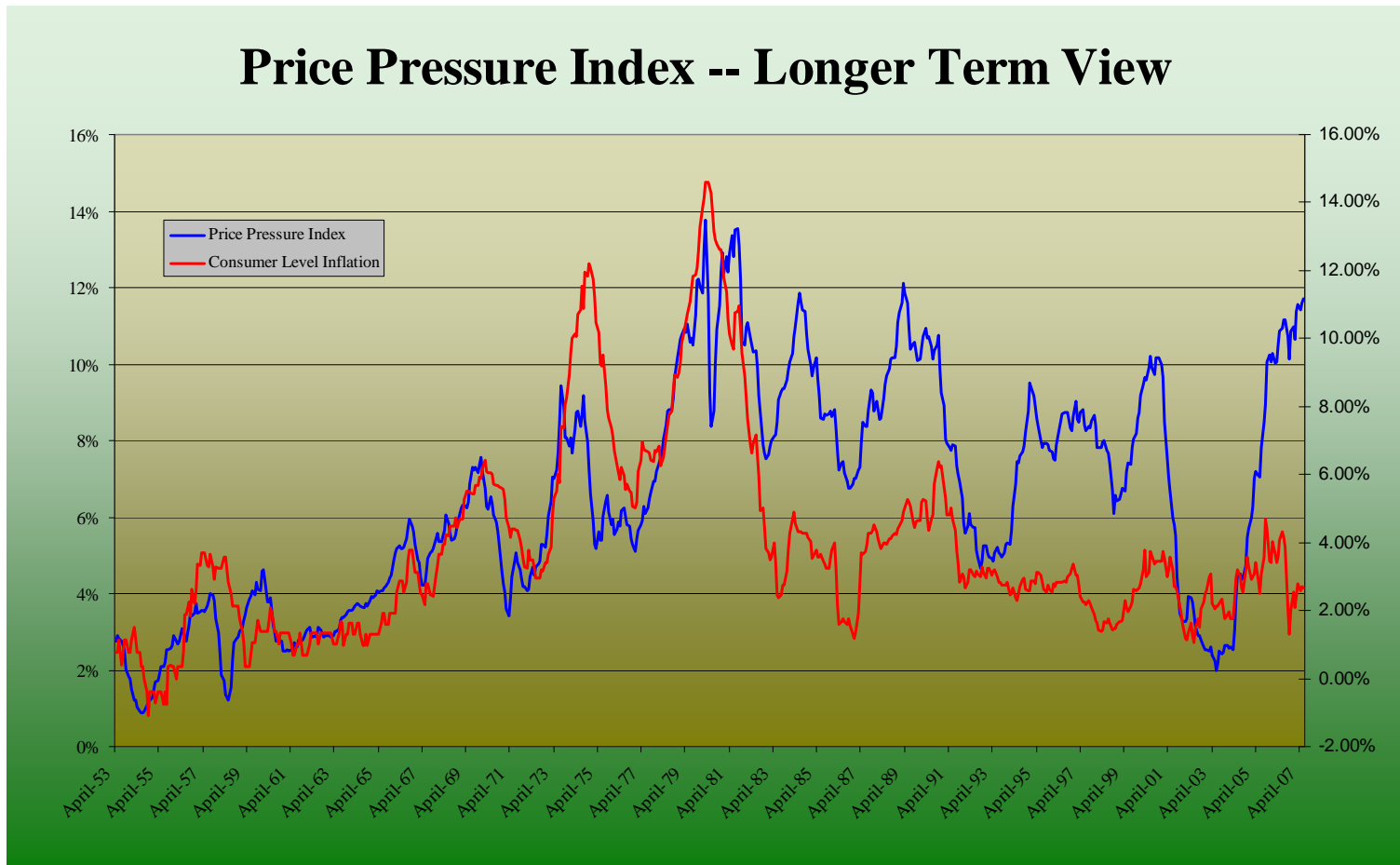
Let's see how much Dr. Ben likes it when wage increases stick. Because if we don't go into a recession and we stay at or around trendline growth, it is hard to see prices climbing down dramatically.

Inflation expectations



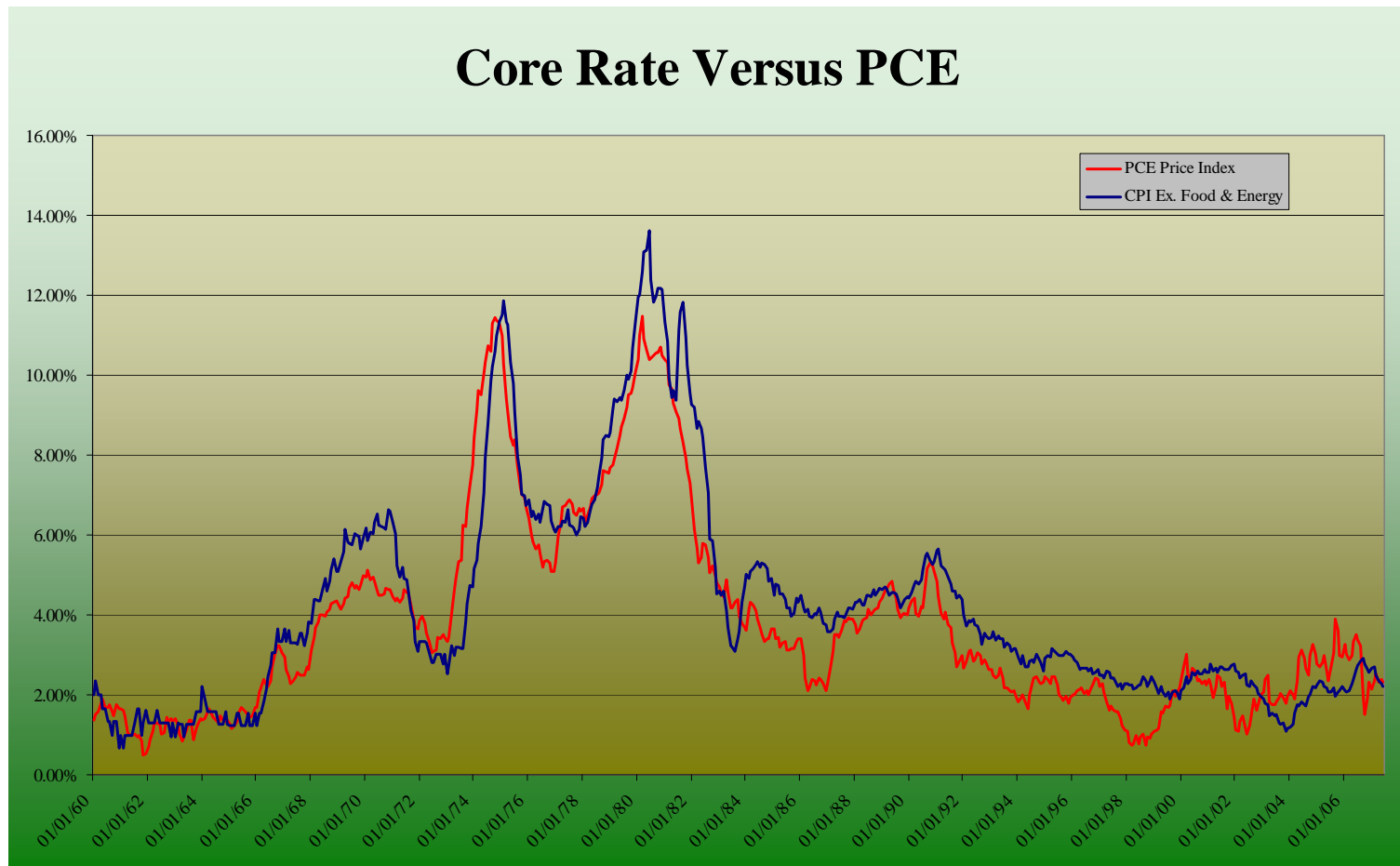
Based on as-reported numbers, headline inflation numbers are cooking along at reasonable rates between 2-3%

Inflation expectations



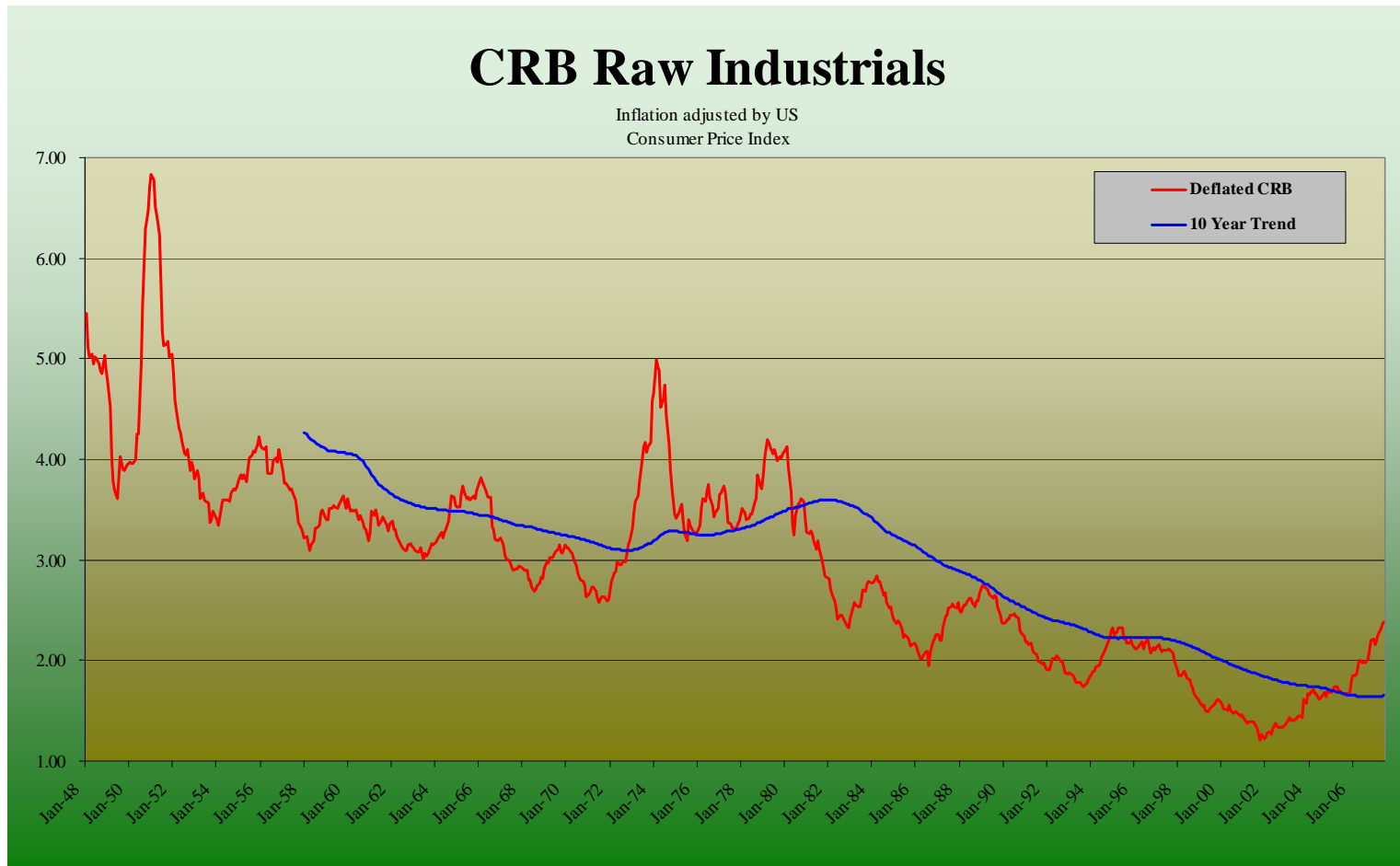
Our proprietary Price Pressure Index indicates that price pressures within the US economy remain at elevated levels.

Inflation expectations



Our TIPS spread model indicates inflation expectations of 2.34%.

Inflation expectations



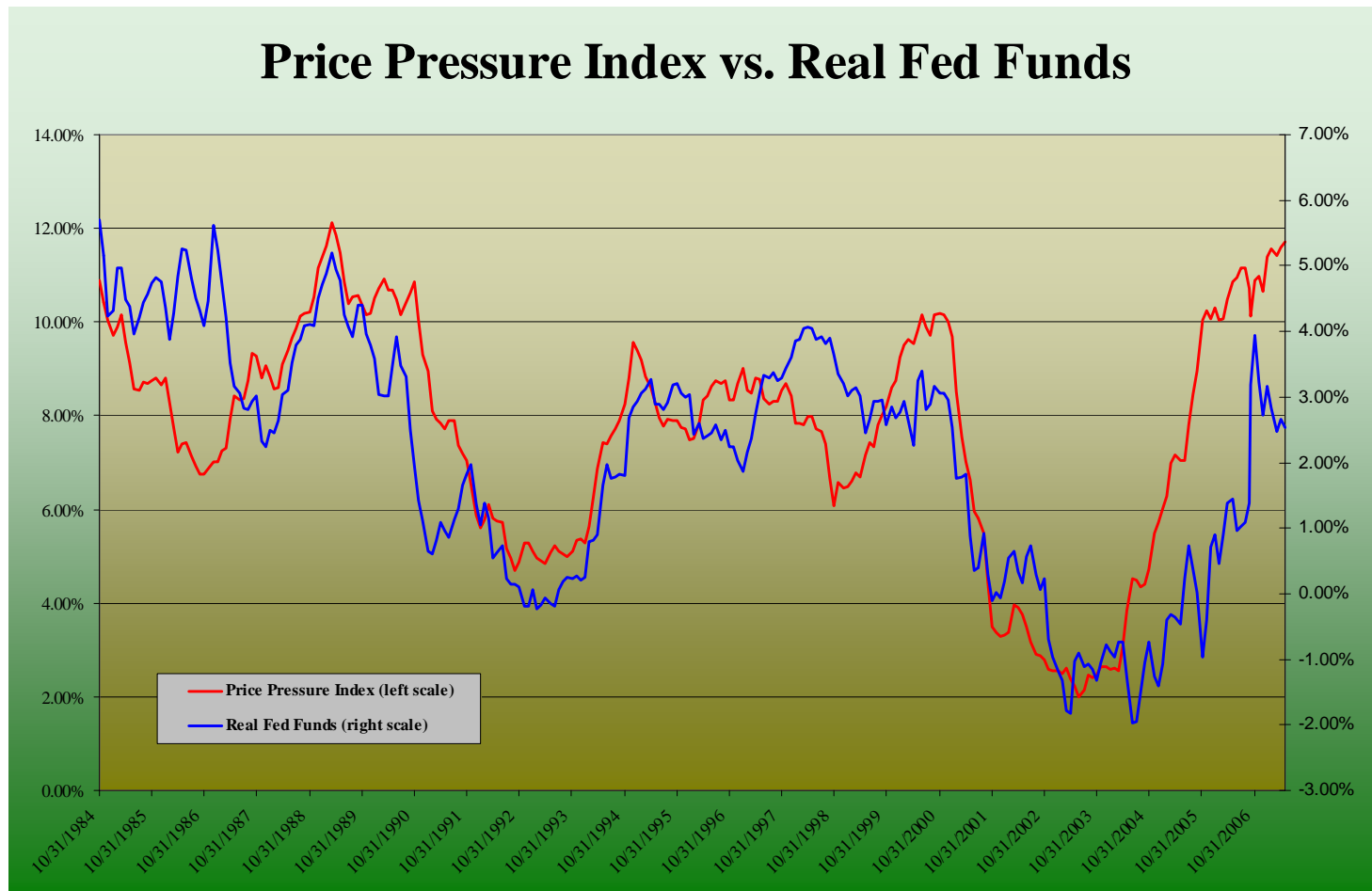
We continue to believe that we are in the early stages of a very long up cycle in commodity prices.

Federal Reserve Watch

Three kinds of people here. People who anticipate a cut in the Fed Funds rate, those who don't, and the small group of people at the Federal Reserve who actually will get to decide.

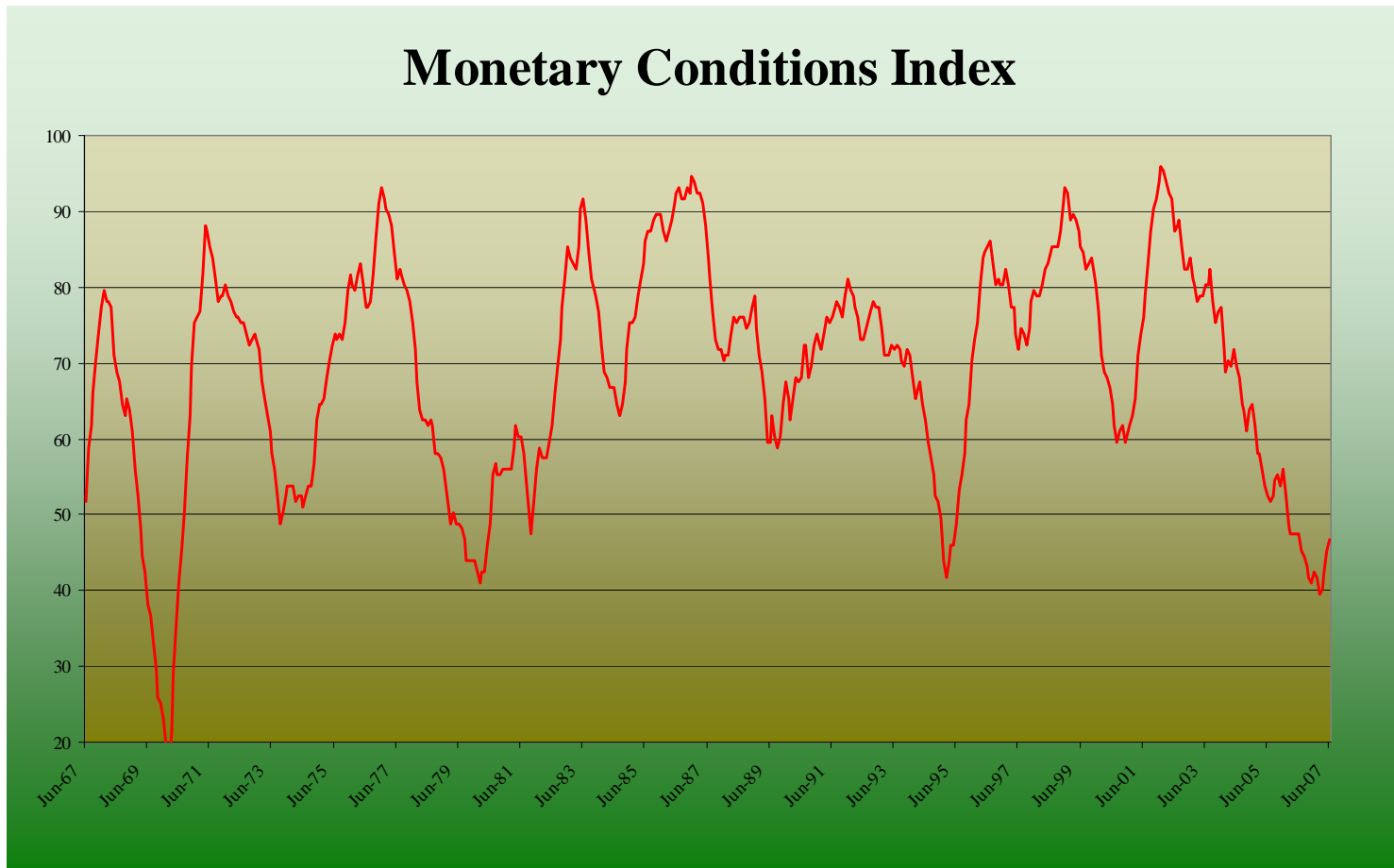
Without a dramatic slowing in the overall economy, not just housing and autos, it is hard to see justification for a rate cut on the horizon until prices slow.

Federal Reserve Watch



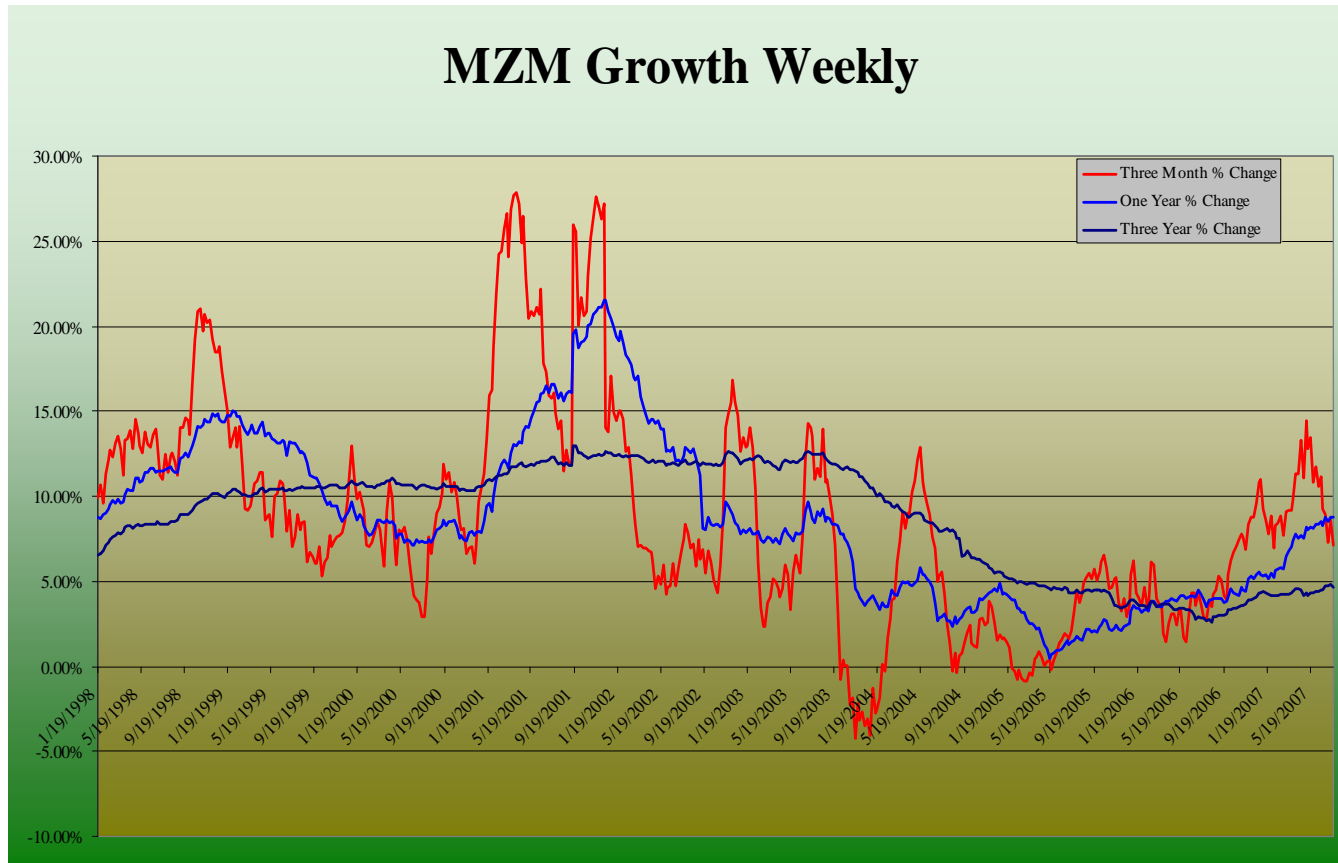
This remains the most interesting chart in the entire chartbook. It will take below trendline economic growth for prices to stabilize (read, a recession), before the Fed starts cutting interest rates again.

Federal Reserve Watch



Has this measure bottomed?

Federal Reserve Watch



Pulling back a bit.

Outlook & Forecast

(as of 7/31/07)

Index	Current	Forecast	Range	Time Frame	Comments
S&P 500	1455.27	Trading range	1400 -1500	9 Months	5-10% over-valued
Ten Year Treasury	4.77%	Trading range	4.75 – 5.10%	10-12 Months	An unanticipated shock here could be damaging, and is not outside possibility.
Inflation (all Urban)	2.66%	2.35 – 2.95%	2.35 – 2.95%	10-12 months	We don't think these accurately reflect costs.
Fed Funds	5.25%	No change	5.25%	0-3 months	Don't look for the Fed to cut rates anytime soon.
S&P 500 Earnings	\$86.90	\$86-94	\$86-94	End of 2007	Not forecasting an earnings decline, but earnings growth will slow.

We are not anticipating a tremendous amount of upside in US markets in the coming three years. The trend for the past period has been gently positive with minimal downside risk. Given some of the economic clouds we see on the horizon, that isn't sustainable.

Our client portfolios are positioned accordingly with an emphasis on non-dollar assets and away from asset classes with out-sized three to five year returns.