

# Q1 2008 Quarterly Investment Commentary



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Spring is here, and with it, longer days and family vacations, a welcome respite from harder weather and tougher markets. The first quarter of 2008 was a difficult time for the Equity Markets and the American Economy as a whole. As we reported in the special March 2008 Market Update letter we emailed in February, home price declines, increasing energy costs, and a resulting slowdown in consumer spending have probably helped to push us into a soft recession.

## Q1 Market Performance

With the markets negatively affected by these concerns, the benchmark U.S. S&P 500 lost almost (-9.5%) in Q1, while other asset classes such as Large U.S. Value, Large U.S. Growth, and Small U.S. stocks were down by (-8.7%), (-10.2%), and (-9.9%) respectively. Developed and Emerging International stocks were also affected, returning (-8.8%) and (-10.9%). Offsetting these negative asset class returns were positive quarterly returns for Commodities, Real Estate, and Fixed Income, gaining 9.5%, 1.5%, and 2.1% respectively. Due in part to the recent strong gains in Commodities and the increasing odds of a potential reversal, we recently reduced our exposure to Commodities by 3% and increased the allocation to Fixed Income. We think money flowing into Commodities had driven prices to an unrealistic level, and while Fixed Income offers relatively moderate returns, it is a good offset to the uncertainties in the financial markets over the next few quarters. We will be watching closely and tactically adjusting our portfolios as conditions warrant.

## Q1 Portfolio Performance

Opes' asset allocation strategy again showed the positive effects of diversification, with all allocation strategies beating their respective blended indexes. Although portfolio values declined, the loss moderation and preservation of investment capital should greatly benefit the performance and eventual accumulation of our clients' wealth over time. We speak often about our commitment to asset allocation, and the sound application of its principles, but less often about our Active Managers and their contribution to the protection of your wealth. We distinguish Active Managers as ones that research and choose individual securities, different from Passive Managers who attempt to replicate an index using predetermined formulas. Because their methodology takes less effort, Passive Managers generally are lower cost and an essential component of a well balanced portfolio; only Active Management, however, can add significant value in a negative market. Most of our Active Managers have outperformed during this recent down market, as their active selection of investments provided a stabilizing influence on our overall portfolios. Managers such as Matthews Asia Growth and Income (exceeded its index by 6.7% in Q1) and Keeley Small Cap (exceeded by 6.4%) are examples of the value that can be added through active management in a down market. We will continue our dis-

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cipline of matching Active and Passive Managers in our portfolios to seek performance in all market cycles.

### **The Economic Slowdown- How Long will It Last?**

As we begin the second quarter of 2008, our focus has shifted from the credit crisis to the slowing economy. Although financial markets have still not returned to “normal”, aggressive action by the Federal Reserve has helped to settle the market by allowing financial companies to borrow on securities they are holding whose value is difficult, if not impossible, to ascertain. Much of the forced selling that occurred late last year and early this year has subsided. On the economic front, recent employment reports, consumer confidence surveys and business investment statistics show that the US Economy is slowing and may already be in recession. U.S. Gross Domestic Product (GDP) fell to 0.6% in Q4 and probably contracted again in Q1. Gasoline continues to rise in price, approaching \$4.00 per gallon in some areas, increasing the cost of any goods or services that use energy and lowering the amount of free cash Americans have to spend. The Fed’s response to the credit crisis and slowing economy has been swift, aggressively lowering the Federal Funds rate to the current 2.25% from 5.25% 7 months ago. The falling dollar has made U.S. exports much more globally competitive; even U.S. automobile companies are planning on strong exports in 2008. We are still confident that this recession will not be a deep one and expect renewed, albeit slower growth towards the end of this year and into 2009. We cannot predict the speed of the recovery, and would not be surprised to see GDP growth staying in the 1% to 2% range through 2009. We have positioned our portfolios slightly more conservatively in anticipation of slower growth and will continue to monitor the economy and our portfolios for any needed changes.

As has occurred on multiple occasions in the past, we believe long term investors will again be rewarded in the early days of a recovery, before many market-timing investors even move back into the market. We remain confident that our disciplined execution of asset allocation and diversification will help minimize losses, while remaining invested to participate in the eventual resurgence of the economy. Like all past winters, this poor market will change and bring forth new life, even if that improvement is very slow and gradual.