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Markets Remain Volatile Even With Fed Action

October Market Review From Your Portfolio Management Team—November 7, 2007

Action from the Federal Reserve in August and September was the medicine needed to reverse the summer market slide and help calm investors. The Fed lowered the Fed Funds rate again at its meeting in late October, but it seemed to offer little solace to investors, as fresh news of problems with mortgages at some of America's largest financial firms has kept investors on edge.

Overall, the market is struggling to break to higher ground even though it was modestly positive in October, with commodities (in particular oil and gold) and emerging markets faring the best. We have continued to migrate portfolios towards 'growth' funds, and away from 'value' funds. This shift has led us towards more technology-oriented funds, which have lagged in recent years, but could be poised to do well in the coming months or years. So far, technology appears to be relatively unaffected by the ongoing housing mess.

Let's review the top holdings at FSA as of the end of October:

- **Schwab U. S. Treasury Money Market**
  Our money market position is down from the levels we saw this summer and currently sits at roughly 25% of assets across all strategies. (Obviously some portfolios will notice higher allocations to money markets, while some portfolios will carry lower money market weightings.) We are content to keep some powder dry through this turbulence, but also believe there are some opportunities in the market ahead.

- **Mutual Series (Core Equity, Conservative Growth)**
  Mutual Series actually represents several funds that are run by the same management team. They include Mutual Shares, Mutual Qualified, Mutual Beacon, and Mutual Discovery. These funds have a value style that has gone out of favor this year, but their relatively high allocations to foreign stocks have helped them post pretty good results for us this year.

- **Merger Fund (Conservative Growth)**
  This fund usually does a very good job in avoiding sharp market downdrafts because it is designed so that half of the portfolio owns stocks and the other half is short stocks (which means they go up when those stocks go down in price). It is generally a good fund to own in choppy markets.

- **Gateway Fund (Conservative Growth)**
  This is another eclectic fund which usually does not get hurt too badly in down markets. It smoothes the ride by employing an option-writing strategy that provides a cushion in a falling market. It won't be able to keep up with the market when things are going strong, but it is a good core fund for conservative to moderate investors.

- **Sector Funds (Core Equity, Tactical Growth)**
  We have purchased a number of specialized funds over the past several months as we have noticed a shift in money flows. The technology area has struggled in recent years, but appears to be regaining favor as investors shift away from financial stocks. This has led us to such funds as Rydex Electronics, Rydex Technology, Rydex Internet, and DireXion OTC Plus. We are also favoring large companies that export heavily, in order to take advantage of the falling dollar. This has led us to the industrials sector, which includes such stocks as GE, Boeing, and 3M.

- **Intermediate-Term Bond Funds (Conservative Growth, Income &Growth, Income)**
  Investment grade bonds have provided a nice cushion to falling stocks this year. As investors get worried about stocks, they shift their money to bonds. Conservative Growth and Income & Growth portfolios have a 10% allocation to bond funds, while the Income portfolios have 20% in this area.

There are plenty of reasons to be concerned as we enter the final months of the year (housing weakness, collapse of sub-prime borrowing, oil prices touching $100 a barrel, among others). At the same time, we are reminded that we are entering a favorable time of year for stocks. The months of November, December, and January are traditionally a strong period for U.S. stock investors. According to BTN Research (by way of DireXion Funds), November has been the best performing month for the S&P 500 index since 1990, with an average gain of 2.4% for the month. If the market could finish the month with a gain of 2% or better, that would be something to be thankful for.

Please contact us if you would like to discuss recent market behavior or if you have changes to your personal situation that might require a change to your risk profile.