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Wow what a year.

On the global scene there was some good political news - progress in Iraq, and possibly in North Korea if they complete their promises and Venezuela if you look at voters' rejection of Chavez's proposed constitutional changes. There was some bad news - tightening of Putin's grip in Russia and the killing of Benazir Bhutto in Pakistan. I am not sure how to rate changes in Iran. Interestingly, both France and England showed signs of turning more pro-U.S. Here at home Washington is more polarized than usual in the pre-election period and inaction seems to be the order of the day. The Washington pundits are forecasting the Democrats will strengthen their positions in the upcoming elections and will take the White House. Protectionism and anti-immigration policies, both of which may hurt investments, are gaining vocal support.

Financially, it was a year with historically normal returns for our clients, that is if you only looked at January 1 and December 31. In between was anything but normal.

Looking into 2008 world wide economic growth is being challenged by the credit problems which are still unfolding. Here are some of the issues we are tracking; most are interrelated.

Housing slump: The down turn in the housing market started the cascading of events. Housing prices went up too fast. They are now coming down but we still don't know how far before they stabilize. Parts of the country where prices had skyrocketed the most have been hit the hardest. Individuals with little equity in their homes are being squeezed including investors who bought with nothing down and those who were buying to "flip" the properties. The drop in the market may erase the last several years of gains. For a long time many complained that housing was unaffordable. The good news amongst all the bad is this is likely to change.

Subprime credit problems: This was kicked off by the drop in housing prices and quickly spread beyond mortgages to other parts of the subprime market. Not knowing where credit problems existed much of the subprime markets came to a halt as banks refused to buy existing debt. Problems were compounded by Wall Street's financial engineering.

Traditionally banks held the mortgages they had created. Now Wall Street bought them, sliced and diced them, and sold them to others, who in retrospect did not understand the inherent risk. Additionally, major banks like Citicorp created new organizations to own this new debt so the full size of the problem was not visible. I have heard estimates that the eventual size of bad debt that has to be written off could be \$300 to \$500 billion, a huge sum. The CEOs of Merrill Lynch, Citigroup, Bear Stearns and UBS lost their jobs for not being on top of this problem. We have always encouraged diversification, even in our bond portfolios. In recent years we have avoided high-yield bonds and utilized TIPS and international bonds. These strategies helped us avoid the worst of the fall out.

Monetary Authorities: Monetary authorities around the world have joined together to take unprecedented steps to keep the world financial markets functioning. Their actions went well beyond lowering interest rates and further actions are likely. Many have criticized the U.S. Fed for not being more pro-active. There is the risk that credit problems could get out of hand and we end up in a situation similar to Japan 10 to 15 years ago when the Central Bank continued to fight inflation instead of deflation, resulting in no economic growth for years. We think the monetary authorities will not make this mistake and will prevent us from falling into a no-growth situation.

Weak dollar, gold and other commodities: As the U.S. Fed reduced interest rates, the dollar dropped versus most other currencies. Most of our clients have significant positions in foreign stocks and bonds so this helped portfolios. A strengthening of the dollar, a possibility over the short term since everybody is so negative on the dollar, would hurt portfolio returns. Gold and commodities rose in response to the lower dollar and this also helped many clients' portfolios.

Sovereign Wealth Funds: Large investment funds run by governments, called sovereign funds, were in the news. They have been quietly accumulating funds from sale of oil and other products and we have been wondering when the Funds would become visible and what role they would play. Their entry was apparent when they provided critical capital to U.S. financial institutions that had been hurt by the sub prime issues. It will be interesting to see what role they will play next.

How we will manage portfolios in 2008: We argued throughout 2007 that a third leg of the bull market (the more speculative stage) could still be in front of us. We remain hopeful that this is still the case and if this happens our clients could potentially do well. We do have to address the possibility that with the unusually large number of issues addressed above we could face a market decline. Looking back at the last bad period, our clients made it through the tech bubble and subsequent bear market drop by diversifying their portfolios. This reduced the magnitude of the drop and positioned our clients to make gains when the market finally turned. In the last couple of years we have further diversified many client portfolios with the addition of real estate, gold and commodities. Our hope is these will help reduce the drop in clients' portfolios should a significant stock market decline occur. Unfortunately, we can't be sure whether this will be true as the markets have a way of humbling the best plans.

Wednesday at Mory's: Our first Wednesday at Mory's was a success. Next luncheons are scheduled for January 16 and February 13. Please come and bring a friend. Call Patrice at 203-867-4396 to reserve a spot as the room has limited seating and we want to keep this a small group.

At Kreitler Associates: We thank our clients for the many holiday cards and remembrances that you flooded us with. It is a pleasure to work with you. Regardless of what comes our way in the next 12 months, we look forward to continuing to serve you as we strive to help achieve your objectives in this fast changing world.

Please note that international investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility.

Commodities may be subject to greater volatility than investments in traditional securities. Investments in commodities may be affected by overall market movements, changes in interest rates, and other factors such as weather, disease, embargoes and international economic and political developments.

Gold is subject to the special risks associated with investment in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

Investments in real estate and REITs have various risks, including possible lack of liquidity; devaluation based on adverse economic and regulatory changes and will fluctuate with the value of the underlying properties.

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