POLK PRIVATE CLIENT-JANUARY 2008

We had a terrific 2007 beating the S&P 500 **THREEFOLD**. We did this by investing for short periods in the top performing markets of China, India, precious and strategic metals, oil, grains, and by betting ***AGAINST*** the U.S. stock markets in March, August, and October-December 2007. We did this with only 25% of your cash at risk at any one time as we took a very defensive position. Our forecast December 2006 was extremely accurate calling for a drop in U.S. stock prices by March 2007, again after the 40 month cycle peak expected in June, a move higher mid September until mid October, and then lower through the end of the year. As we said in August 2007, the worst is yet to come both in the U.S. and Internationally. We took advantage of our forecasts to the extent we felt prudent knowing our risk tolerances while awaiting better prices to come during the next recessionary period. Sometimes cash is king. As our long time clients know, we predicted 20 years ago that the top in the real estate market should occur around the year 2006. This was the normal 18.6 year real estate cycle expected peak so our objective was to sell out most of our real estate prior to the peak. We were able to accomplish that for the most part leaving less than 5% in private REIT's not subject to market risks, paying high dividends. The fact that this 18 year cycle occurred on time reinforces my strong beliefs that there is "something out there" which triggers these regular economic behaviors regardless of the people, places, and things of the time. After publishing my newsletter for twenty years, in 1992, I published my first book, ***THE INVISIBLE HAND.*** I gave my cycle projections for the next peak in U.S. stock prices at the 9 year cycle to occur in the year 2000. The 72 year panic cycle was predicted after the 2000 peak projecting a drop in stock prices of at least 33% for the broad U.S. stock market and 66% for the Nasdaq stock prices, a Golden number retracement. The Dow Jones Industrials dropped -36%, and the Nasdaq nosedived -75% right on schedule. Cyclically, U.S. stocks entered a nine year bear market and we focused on hard assets and commodities and the Emerging markets in the Far East. The cycles projected some U.S. stocks to recover from 2003 until 2007 and the S&P 500 finally got back to its 2000 year high. I wrote in 2003 that the next recessionary period should occur at the normal 4 year business cycle at the end of 2007. In 2003, we concentrated our stock positions in the Far East, China, India, as those were expected to be the fastest growing economies. They were and are but as I said in March 2004, it's the "**WILD, WILD EAST** so we will take profits regularly." We have. These stocks tripled. Now, the U.S. recession is "on time". What's next?

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Our analysis of the cyclical nature of the financial world and subsequent projections were very accurate, and since 2000 we have beat the S&P 500 by over 20% per year with **NO** negative return years. Luck? We performed the same in the 1980's and more than equaled the markets in the 1990's.
DISCLAIMER: OUR PAST PERFORMANCE IS NO INDICATION OR GUARANTEE OF FUTURE PERFORMANCE. MOST INVESTMENT EXPERTS SAY THEY CANNOT TIME THE STOCK MARKETS.

However, in our cycle analysis, history does tend to repeat itself. As I wrote again last year in our December 2006 newsletter; much like the 1929-1932 stock market crash, stocks then moved higher until the 1937 recession and then fell again by - 48%. I expected similar results after the 2000 crash, recovery from 2003-2006 then lower into 2008 and attached a chart of the Dow Jones from 1924 to 1938 vs. the Nasdaq 1994 through 2006. With a minimal time variance shift, at that point, plotting the indexes over each other was an eerily ideal match. Expanding the chart through the end of 1937 and into 1938 we see a move lower from July to December 1937, a brief move higher in late January/February 1938, then down another -25% in March, then higher through December 1938 up 59%.

While we began shorting (betting against) the U.S. stock market in late July 2007, "Wall Street" issued reports telling investors to "buy the breakout". They said "the S&P 500 reached the March 2000 peak on July 12, 2007…, and in the past since 1900 each time it took five years to recover to prior highs, stocks then went up 10.3% in following six months." (Lehman Brothers-7/16/07 attached). They were one among many predicting the same. Of course my clients know that we always follow the Polk Investment Rule Number One: ***NEVER LISTEN TO WALL STREET!***
In our August newsletter I said the sub-prime mess would sink many financial stocks and they proceeded to drop -50%+. Market pundits panicked with existential mental breakdowns but I said the Federal Reserve, the U.S. Government (us taxpayers), and other world banks would bail them out. They are pulling out all the stops but it won't work. Our short positions continue to move higher while stocks are tanking again. However, "Jack be nimble, Jack be quick!" Average positions long and short the market are only lasting 5 trading days and program trading is back with a vengeance this time with all the new hedge funds participating.

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Wall Street firms are like shoe salesmen; they will sell you anything on the shelves. However, in defense of shoe salesmen, at least they will try to make sure the shoe fits, Wall Street firms don't care.

This time they not only screwed the innocent investor, but got stuck with a lot of junk bonds (mortgages) that they could not get rid of fast enough. Now, they want you and I the taxpayer to bail them out. As I said in August 2007, the Federal Reserve, Congress, President Bush and all the Presidential candidates will probably cave in as they face this financial crisis. The only candidate who said a bailout would be a bad idea in August 2007 was Mitt Romney, but I wondered how long that might last in an election year. Mrs. Clinton wants a foreclosure "timeout". Sounds like a first grade teacher with unruly students who sticks them in the corner but gives them candy to shut them up. Let's reward bad behavior. Political pandering for votes.

In Polk Private Client-August 2007, we discussed the sub-prime mortgage market and the devastating effects it will have on the world markets. I stated the worst was yet to come as the heaviest resets to higher mortgages would not occur until after February 2008. I thought that Wall Street would panic and they have firing their top executives who were dumb enough to keep too much of these poor performing loans. The King of Bonds, Bill Gross at Pimco panicked calling for a government bailout of Rooselvetian proportions, the Federal Reserve panicked by lowering interest rates, and the U.S Government is panicking with a proposed fiscal stimulus package trying to stem foreclosures and a recession. Of course, doing so will only prolong the pain and possibly change the possible future outcome; an even longer recession. Redistributing income taxes to help pay someone's mortgage and heating bill will not stimulate the economy. FDR Socialism and Keynesian economics fail eventually much like Communism did in 1989. Unless we have a leader who understands how capitalism works, how big government is the problem, and who is willing to address the bankruptcy of Social Security, Medicare, and Medicaid, the empire will fall. Unfortunately in the real world, you must let people, business, and banks fail, not reward them, or you end up like Japan in a twenty year+ depression, backed into a corner with low interest rates but a weak currency. So far that's the approach the Federal Reserve and Federal Government are taking. The Ivory tower intellectuals are too ignorant to want to learn from this recent history lesson and too arrogant to admit they are wrong.

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Before the 1929 stock market crash the financial services industry was the wild, wild, West as business could have their fingers in banking, investments, insurance all in collusion with themselves and for their own benefit. The 1929 crash occurred, depression set in, and the Glass-Stegall Act came about to separate these financial services. As I wrote about in 1998, President Clinton and Congress were going to give away the financial world to the major banks in 1999 by rescinding the Glass-Stegall Act. Treasury Secretary Robert Rubin had a big job offer and the Clintons could get rich if CitiBank was allowed to buy Travelers Insurance and Smith Barney. The Act was rescinded, the deals went through, Rubin joined CitiGroup, and the Clintons' who walked into the White House deducting Bill's used underwear as a charitable deduction, walked out $50 million dollars richer.

Banks got into areas beyond their comprehension like investments and insurance, duped investors into purchasing junk mortgages rated AAA, got stuck with some of the remains which they are now writing off, and now must be bailed out by U.S. taxpayers and by foreign governments. Our largest banks and brokerage houses are getting funds from United Arab Emirates, Singapore, and other foreign country funds at high credit card interest rates, and us for free if possible. Guess where Bill Clinton gets most of his paycheck these days but he's not the only one. Anyone connected to the banking, mortgage, investment banking, insurance and real estate markets got rich on the masses, are now taking losses on garbage they could not dispose of and want the prudent and wise investor and taxpayers to keep them in their beachfront properties living large. Unfortunately, the masses are just dumb and scared enough to do it.

As we said last August, the U.S. Government, the Federal Reserve and other world banks will cave in to the financial pressures and prop up the markets on a temporary basis prolonging the problem by nine years longer than necessary. We will continue to play the markets long and short on a Fibonacci daily basis, 1,1,2,3,5,8,13,21…as fear and greed drive the short term trades. Profit taking daily, weekly will be the norm until after the Presidential election.

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