

MCM Market Outlook

MARCH 3, 2008

Inter-Quarter Update letter

After last week's sell off, the U.S. stock market is down about 10% this year. The primary factor scaring investors is continuing uncertainty over the length and depth of what is commonly referred to as the credit crises. Last week, two new reports were released. One projected total worldwide losses of \$400 billion and the other \$600 billion, about half of which will be in U.S. financial institutions. So far U.S. firms have written off about \$125 billion and raised \$90 billion of new capital, primarily from foreign sovereign funds.

These numbers suggest the loss recognition and capital raising process is only about 50% completed. We expect it will be largely finished by the end of the June quarter.

Three factors need to align to reverse the market direction. The most important is an end to the credit crises. The second one is the valuation of stocks as measured by Price Earnings Ratios. With stock prices at 13 times this year's earnings, that condition has been met. Stock valuations are at the low end of their historic range. The last one is low interest rates and a positive yield curve. Interest rates are low and when the Federal Reserve drops the Fed Funds rate to 2.0%, the yield curve will have a positive slope (long term rates higher than short term rates). That may take two or three more Federal Reserve rate cuts.

Then, two of the three conditions for a market reversal will be in place. That brings us back to the credit environment. As stated above, by the end of June, we expect the total losses to be well defined and the balance sheet strengthening of the major banks and brokerage firms to be largely completed.

At that point, we will have historically cheap stocks, low interest rates and a strong global economy, which all adds up to a positive environment for stocks.

In the meantime, we don't expect the chatter about "recession or slow down" to have much of an impact on share prices. Over the next few weeks, as we continue to read about slowing employment, \$100 oil, rising commodity prices, etc, keep in mind most of that is already reflected in share prices. The strong global economy has been minimally impacted by the credit situation in the U.S.

While speculating about when the market will reverse is a popular exercise, it is not productive. What determines how well your portfolio performs over time is the earnings performance of the companies. Happily, we can report your companies continue to operate very profitably. The fourth quarter results have now been reported and earnings were up over 20%, led by the technology sector. We expect a similar performance this year, despite a slow down in the U.S. economy in the first half of the year. History is very clear. When companies do consistently well over an extended time period, so do the stocks.

That is why our total focus is on company performance. That philosophy has worked well for a long time and our confidence in it is undiminished. Please don't hesitate to call with questions or comments.