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Election Year Begins on a Down Note as Recession Thoughts Rise to the Surface

Monthly Update from Your Portfolio Management Team—February 7, 2008

Research from the *Stock Trader's Almanac* suggests that the three-month span of November-December-January is historically the strongest span of the year, with an average gain of 4.5% per year (over half of the entire year's gain), going back to 1950. Well, that tendency has not played out this time around as the three-month return for the S&P 500 index from November through January was -10%.

For the month of January the S&P 500 index finished down 6%, which is one of the worst Januarys in over 50 years of market data. What is also interesting is that in every year when the market had a bad start to the year, which we will define as a decline of 5% or more for the month, the market finished with a weak return for the entire year. That is, when the market has had a bad January, it has not managed to shake off its troubles and post a strong year. The average return of the S&P 500 in years when the index finished the month of January down 5% or more is -4% (using data from *Stock Trader's Almanac*). So, historically speaking, the difficult beginning does not bode well for a strong year in 2008.

Of course, we believe there is a good possibility that we will get an excellent buying opportunity at some point this year once we get through these current tribulations. In 1990, the economy slipped into recession, but there was a great low-risk buying opportunity in the fall as Fed actions earlier in the year began to take effect later in the year. So, the fact that things seem bleak at the moment, does not mean that conditions won't turn dramatically more positive later in the year with further Fed and fiscal stimulus.

The FSA portfolios have maintained high money market levels over the past several months as the stock markets have bounced around (mostly down). The table below illustrates just how high we have pulled our money market positions across all five FSA strategies.

Strategy	Stock Funds	Core Funds	Bond Funds	Inverse Funds	Money Markets
Conservative Growth	0%	6%	11%	--	83%
Core Equity	3%	2%	NA	--	95%
Income & Growth	--	--	11%		89%
Tactical Growth	11%	--	14%	5%	70%
Income	NA	--	21%		79%

Note: Allocation percentages are as of January 31, 2008 and are an average of all accounts within the objective. Individual account allocations may differ from these averages. Core Funds represent lower risk funds that tend to hold up well in difficult markets. Inverse Funds typically move counter to the direction of the broad stock market—rising in value during falling markets and vice versa.

With the exception of some bond funds (which have performed pretty well this year) and a small collection of eclectic stock funds, we are resting in the safety of money markets. Of course, we have to ask ourselves when the environment might improve to the point where we would begin to move some of that money market position back to equities. The market has already rallied nicely from its low in late January. We expect the next few months to be schizophrenic as investors fret over recession fears with hopes that the Fed and the U.S. government will take the appropriate measures to keep the economy moving forward.

The government released its first estimate of economic growth for the fourth quarter 2007 and the result was a tepid 0.6%, far below the 4.9% growth rate posted in the third quarter. That number is certainly sending off alarm bells that the economy is flirting with recession, and both the Fed and the U.S. government had better keep working hard to help the economy recover. With 2008 an election year, elected officials from both parties will be willing to do almost anything to keep the economy from slipping into recession.

Given our high money market position, we can watch the ongoing volatility with some detachment, as most portfolios have very little downside risk at this point. As we mentioned above, once this turbulence is over, there could be an excellent opportunity to get back into equities and enjoy a nice stretch of solid gains, similar to what we witnessed in 1991 or 2003. We will do our best to stay on top of developments in the market and get your portfolios invested when it is prudent to do so.

If you have any questions about your specific accounts, please do not hesitate to call or email us.