Monthly Chartbook

Mid Year Review

June 2008

Mobile West Rotary Club

Cornerstone Investment Management & Consulting

Mark E. Davidson, CFA – Director of Investments

Scott M. Koser, CFA – Director of Research

Amy C. Jernigan – Research Associate

Introduction

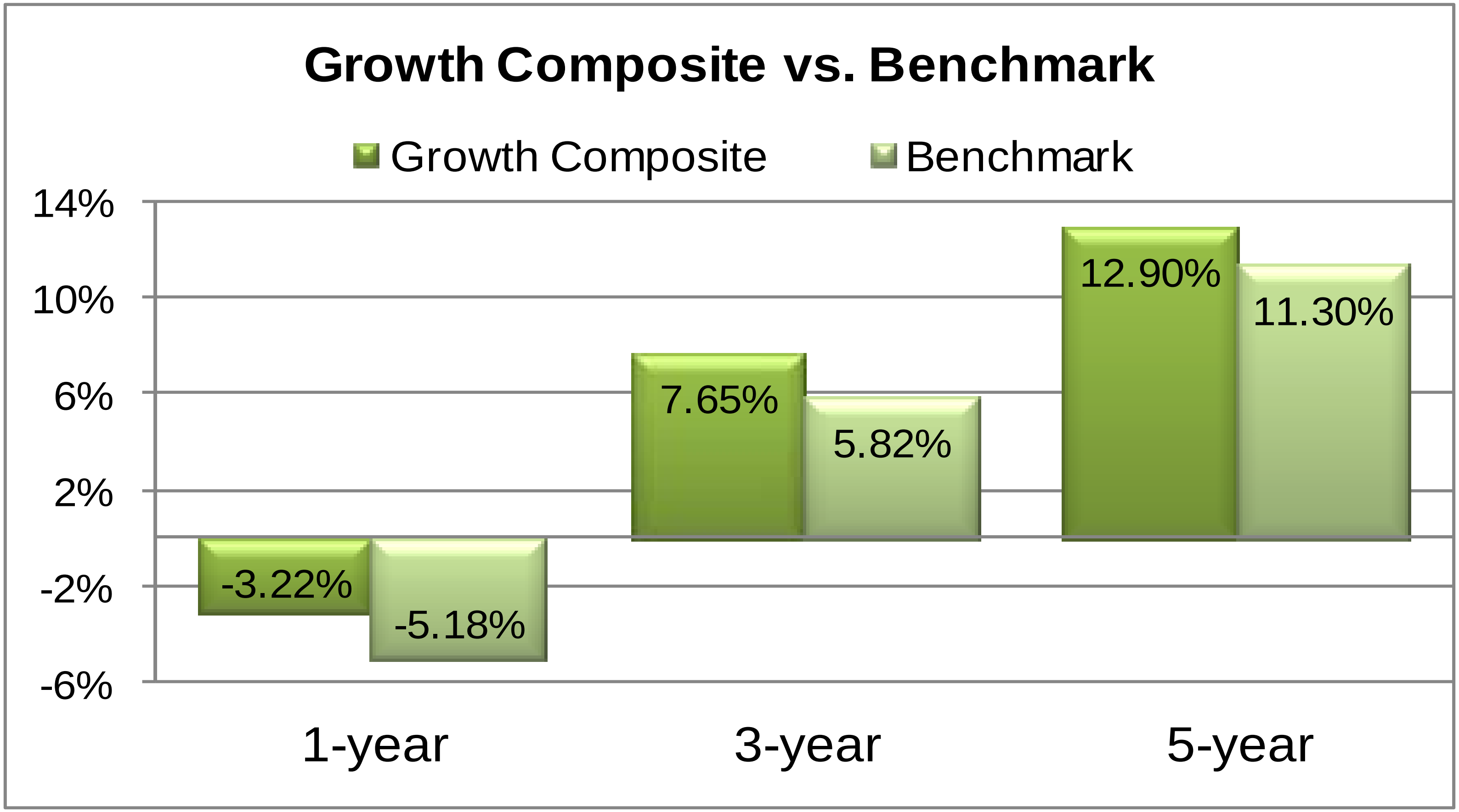
Mark and Scott are two of only seven Chartered Financial Analysts (CFA) in the Mobile Metropolitan Statistical Area (MSA)

Worldwide fewer than 90,000 people have achieved the distinction of becoming a CFA charterholder

For more information on the CFA program visit http://www.cfainstitute.org/

The Fed, Inflation & You

Why listen to us?



CORNERSTONE
Investment Management and Consulting

invest*with*cornerstone.com

06/17/2008

Subprime is just a "normal" credit cycle

What the Financial Press has taken to calling the "Subprime Crisis", people with marginal credit not repaying mortgages as expected, is really just a good old fashion credit cycle.

– It seems so new and worrisome because it has been so long since we had one.

– Don't worry, credit cycles are a normal part of market capitalism.


BEAR
STEARNS

The Most Powerful Man in the World

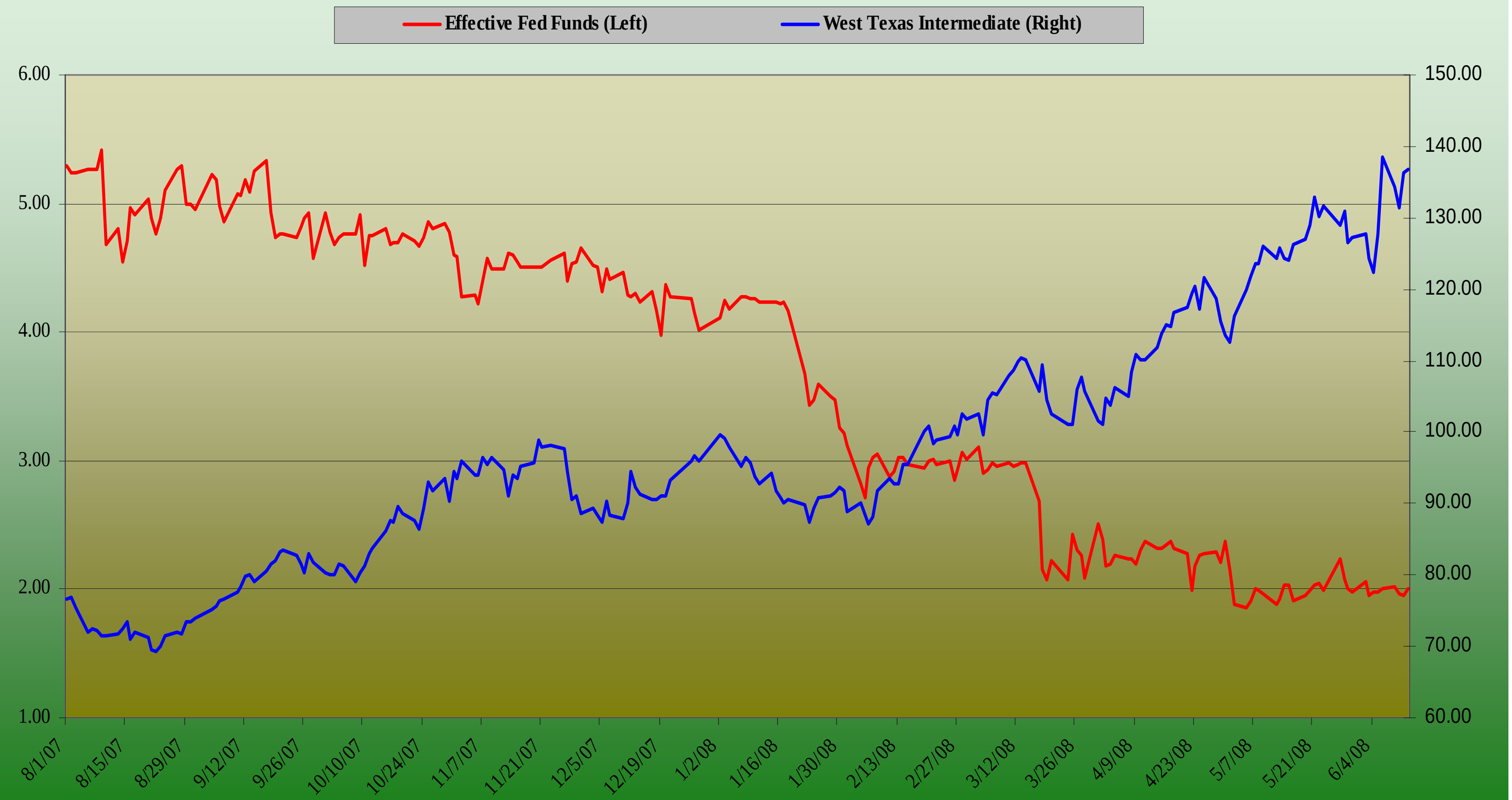
Timothy F. Geithner, President of the New York Fed

CORNERSTONE
Investment Management and Consulting

invest*with*cornerstone.com

06/17/2008

Fed Funds vs. Oil



CORNERSTONE
Investment Management and Consulting

invest*with*cornerstone.com

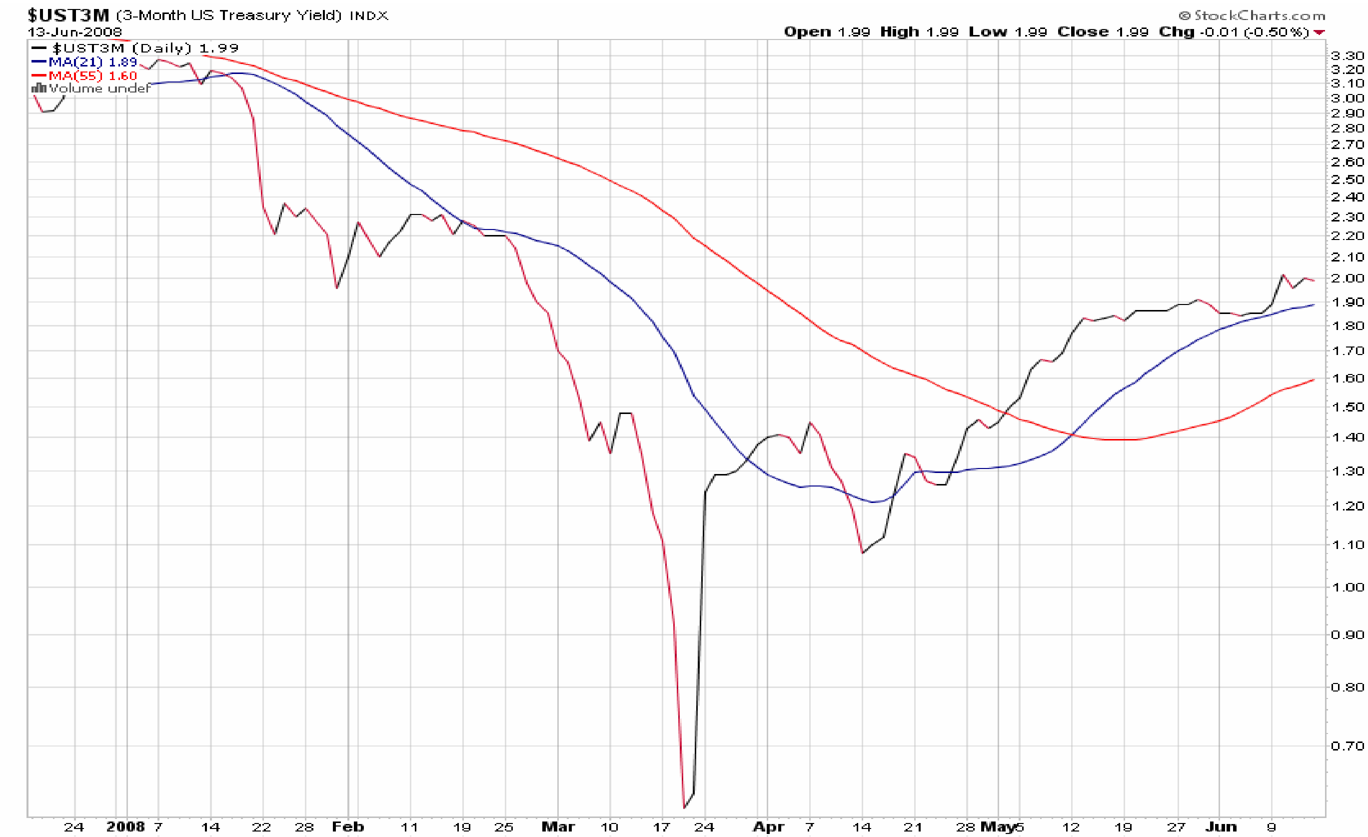
06/17/2008

Big Picture

The immediate grasp of the crisis has passed; now the real worry is the dilutive effect of the recapitalization on the banking system.

The *next worry* after that is inflation. If the dollar doesn't get the solid bounce so many expect, watch out inflation expectations.

Macro-economic research



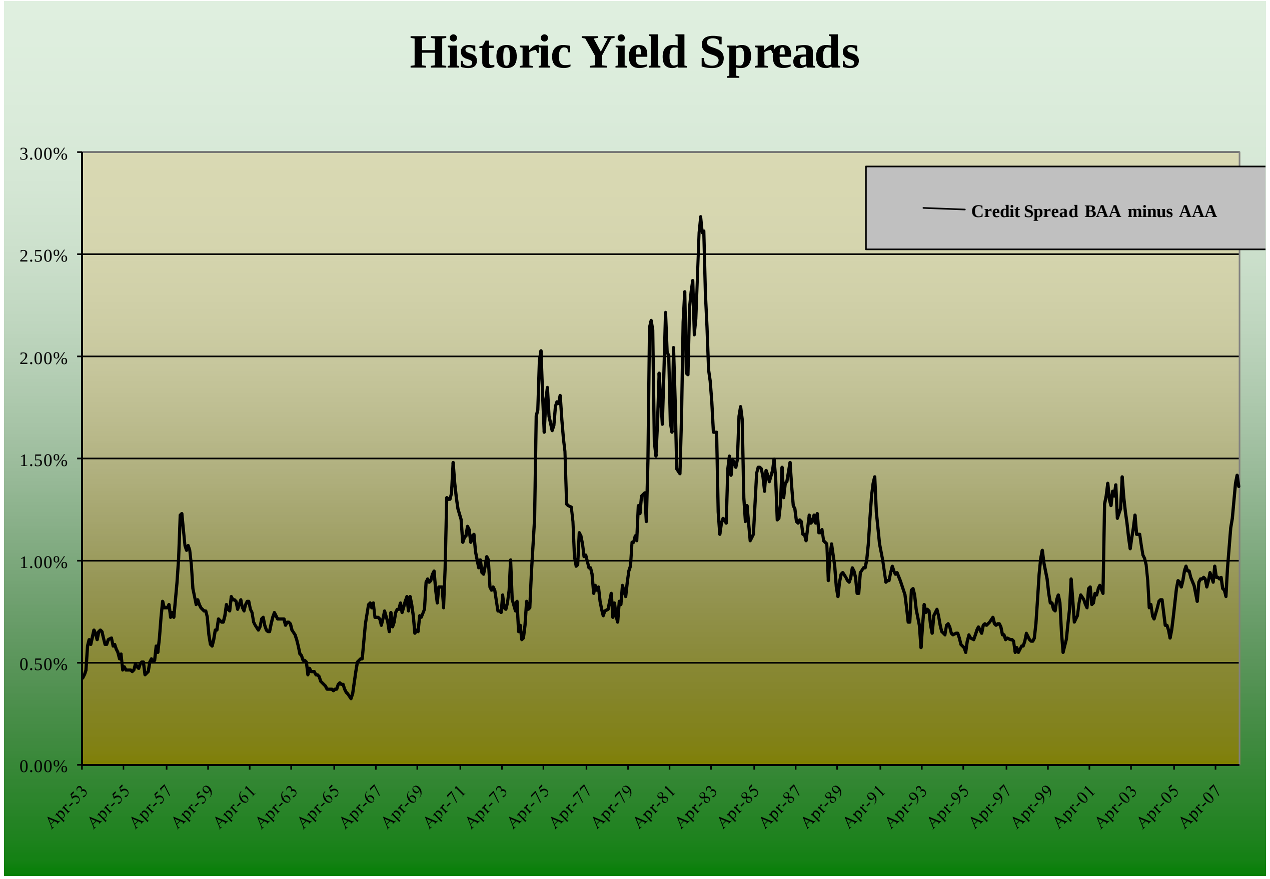
The yield on Three Month Treasury Bills shows some return to normalcy. Risk aversion was so great right before the BSC rescue that yields almost fell to zero.

CORNERSTONE
Investment Management and Consulting

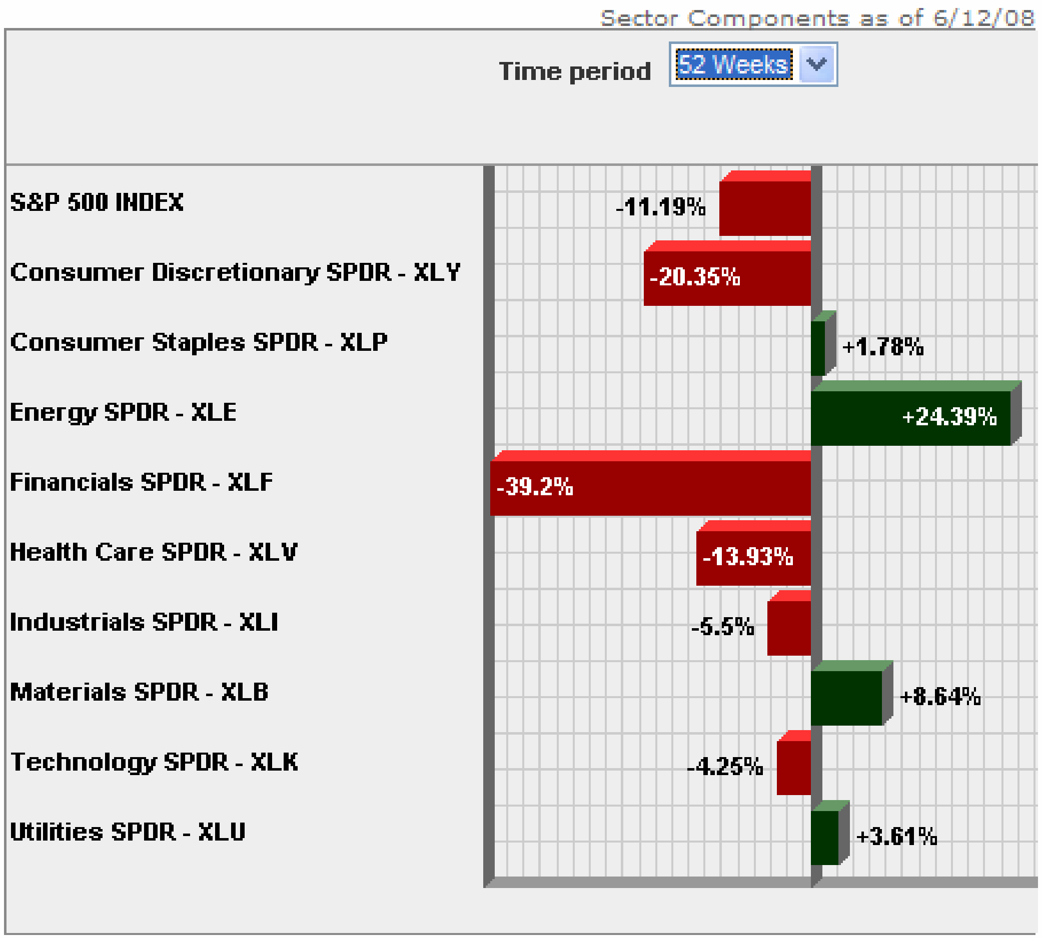
invest*with*cornerstone.com

06/17/2008

Macro-economic research

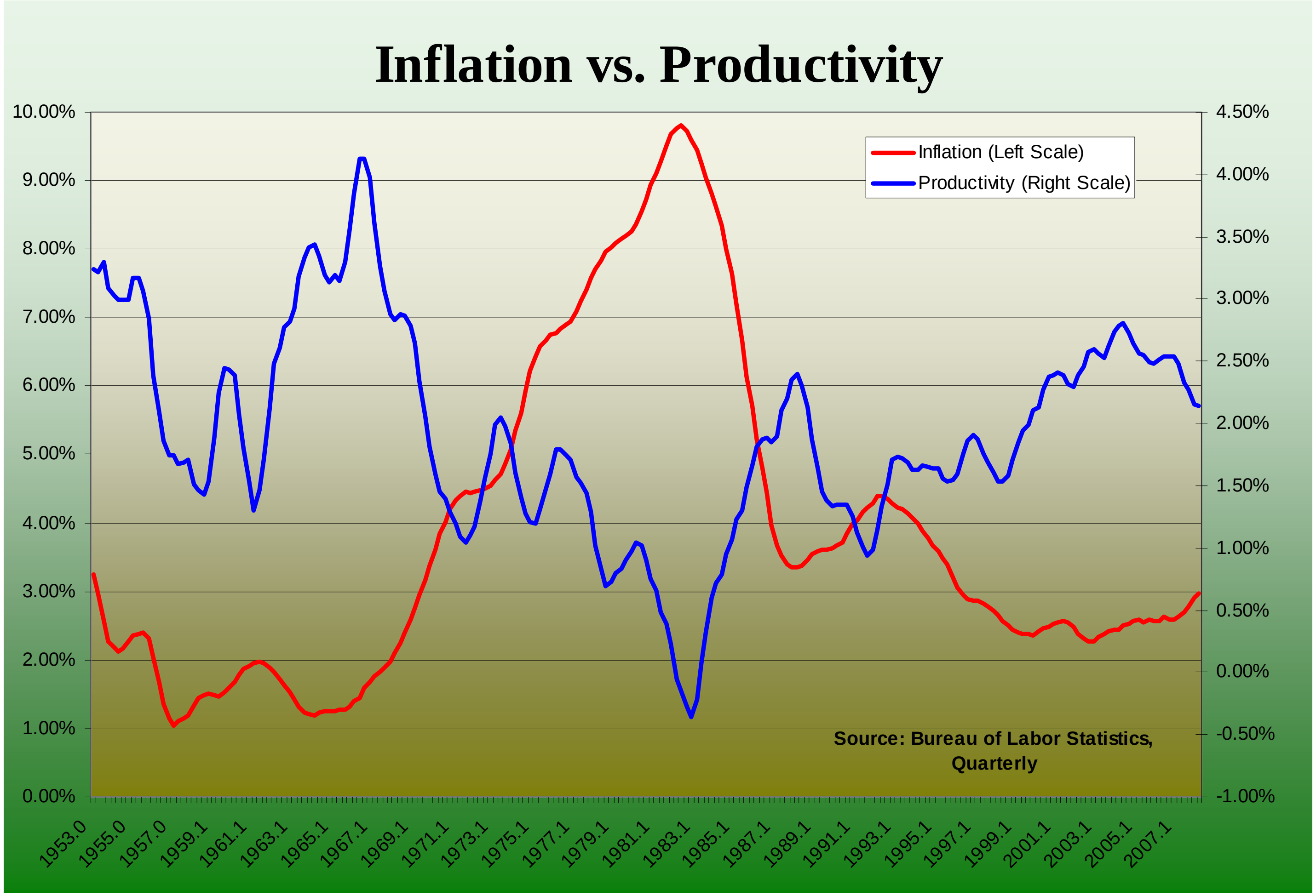


Yield spreads on the most risky class of investments are what is in the driver's seat. The last two recessions where preceded by in increase in the credit spread.



Energy and Materials are booming because they are a store of value in a world where the Fed just prints money to solve problems.

The Problem we face….

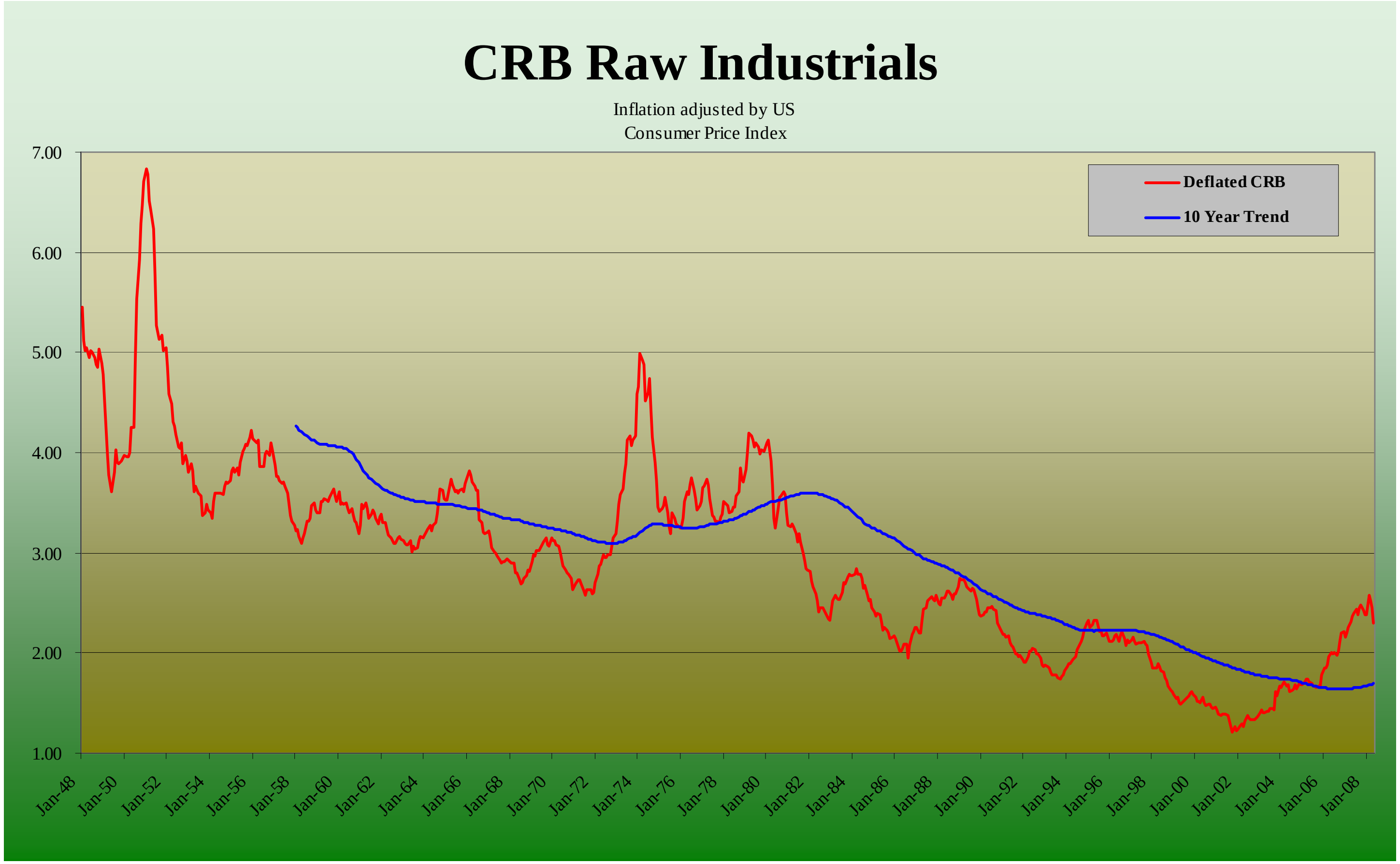


Plain and simple, inflation destroys productivity.

The Macro View

- It's all about leverage, access to funds and de-leveraging.
- The Global economy is benefiting from commodity prices (emerging markets) and increased final demand from the so-called BRIC's (Brazil, Russia, India, China).
- It seems as though everyone is betting **against** the US dollar and **on** the ability for the World to de-couple from US growth.
- A Consumer/Retail recession is upon us. How long and how deep will be an open question until we get past the effects of the stimulus checks.

All Urban CPI deflated CRB Raw Industrials



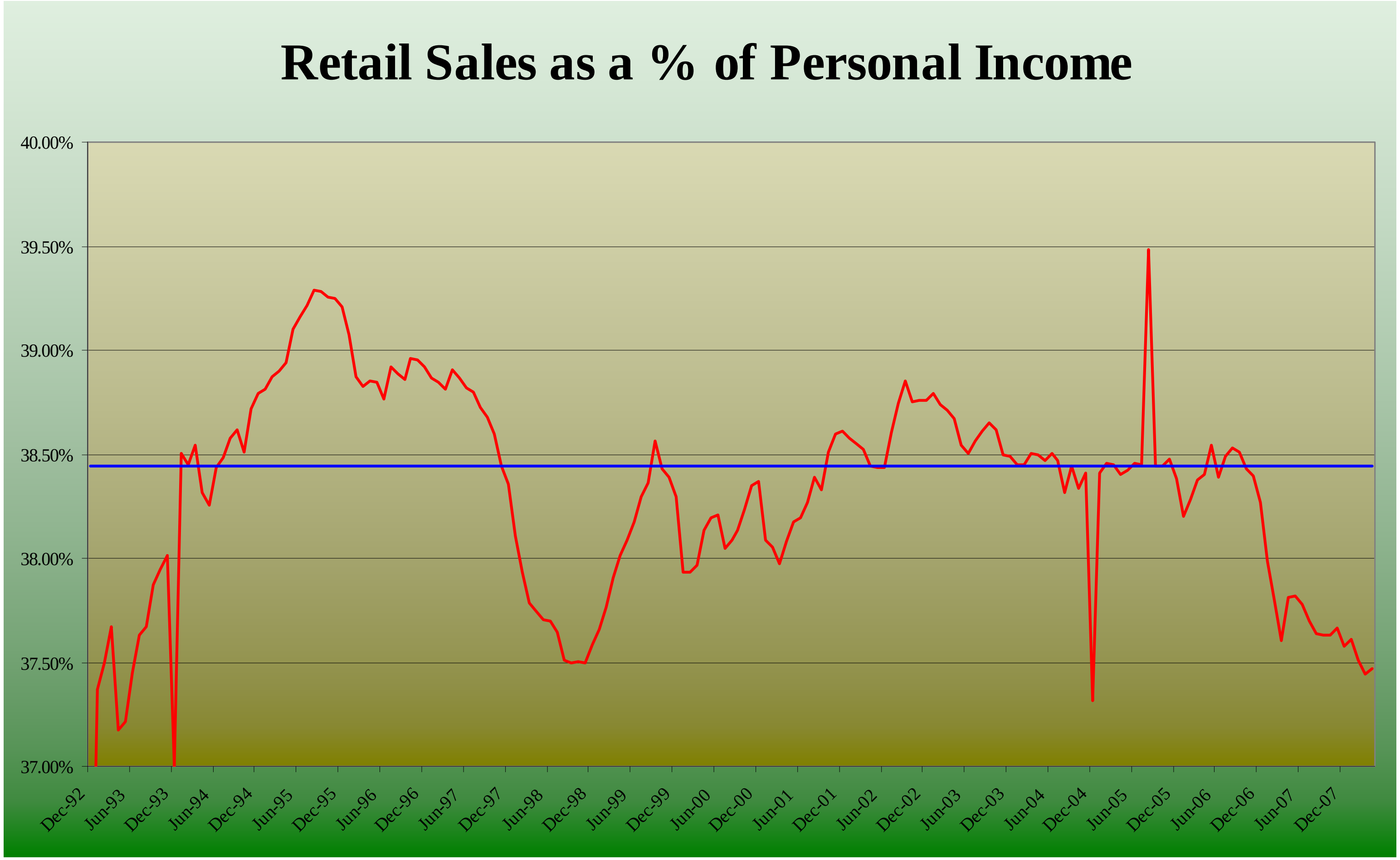
If this is a 10-25 year Super Cycle, where are we on price??? Year 5, year 10? How about 5 years in, but priced like year 10. Not much room for error for the speculators who are long but don't own the raw commodity.

CORNERSTONE
Investment Management and Consulting

invest*with*cornerstone.com

06/17/2008

Retail Sales as a % of Personal Income

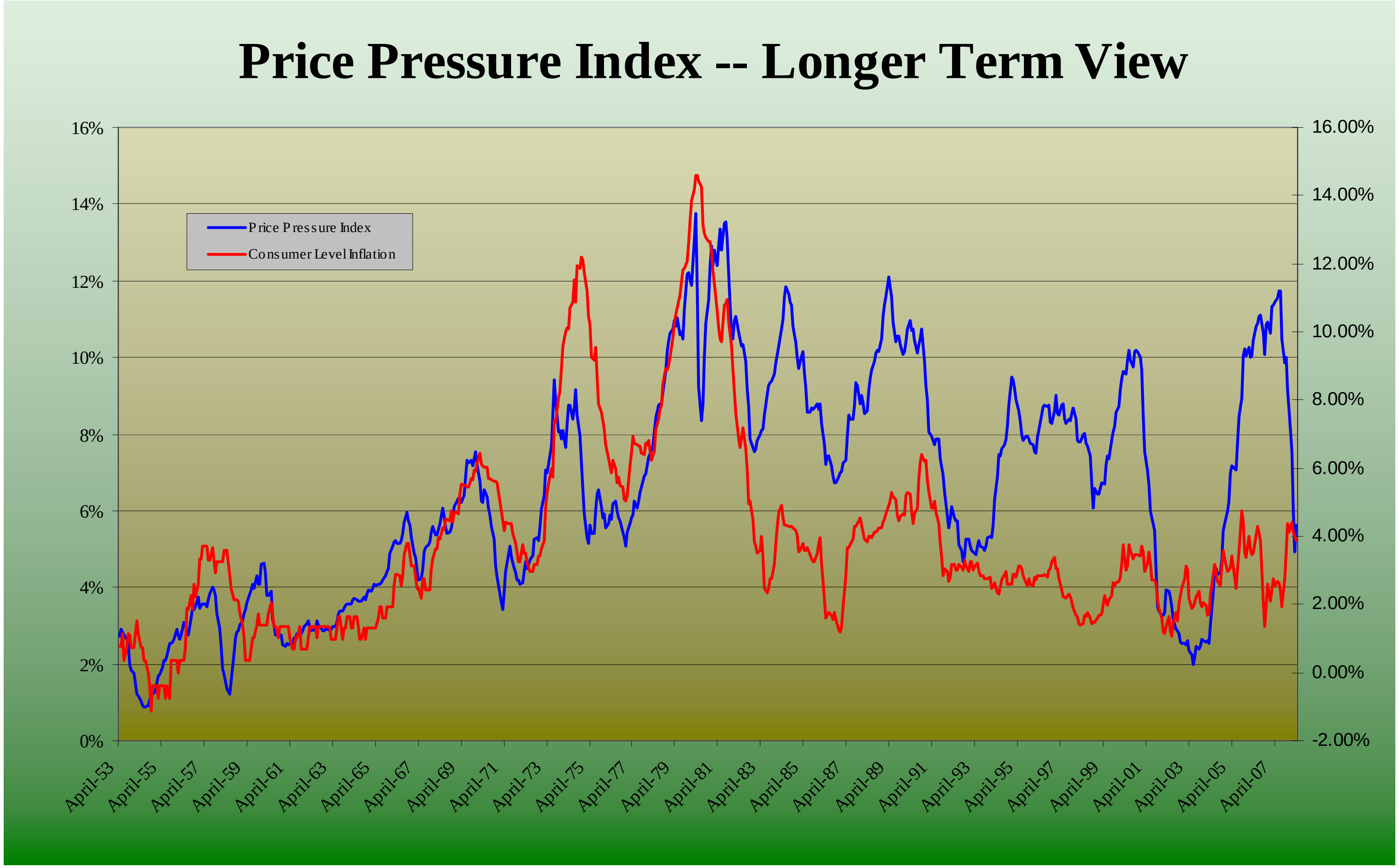


Retail looks to be in a rocky environment now that Mortgage Equity Withdrawal (MEW) is spent.

Inflation expectations

Inflation has become a problem the Fed has to address, right here, right now…

Inflation expectations



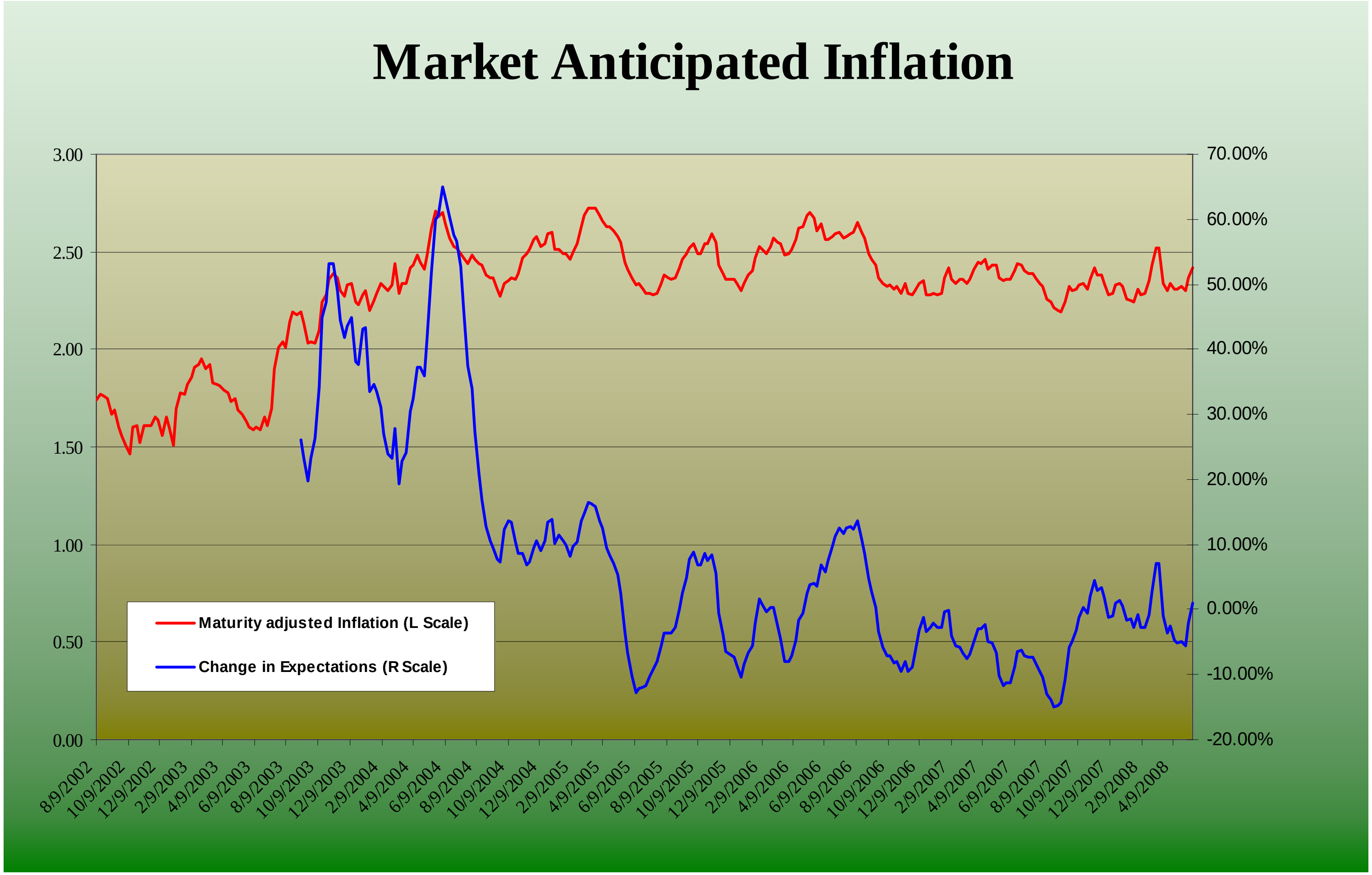
The decline in the Price Pressure index is mostly related to falling short term interest rates. Most price pressures remain.

CORNERSTONE
Investment Management and Consulting

invest***with***cornerstone.com

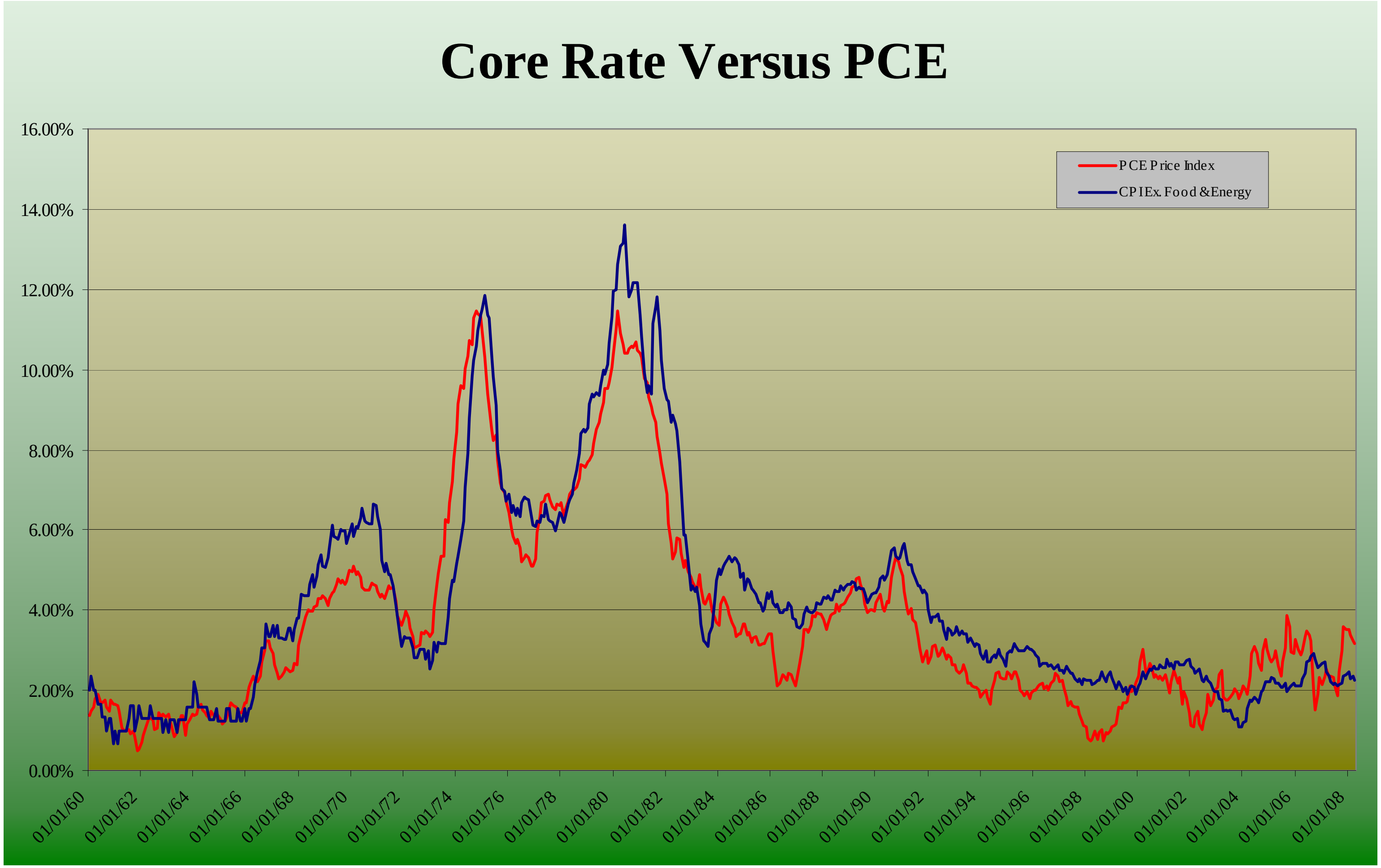
06/17/2008

Inflation expectations



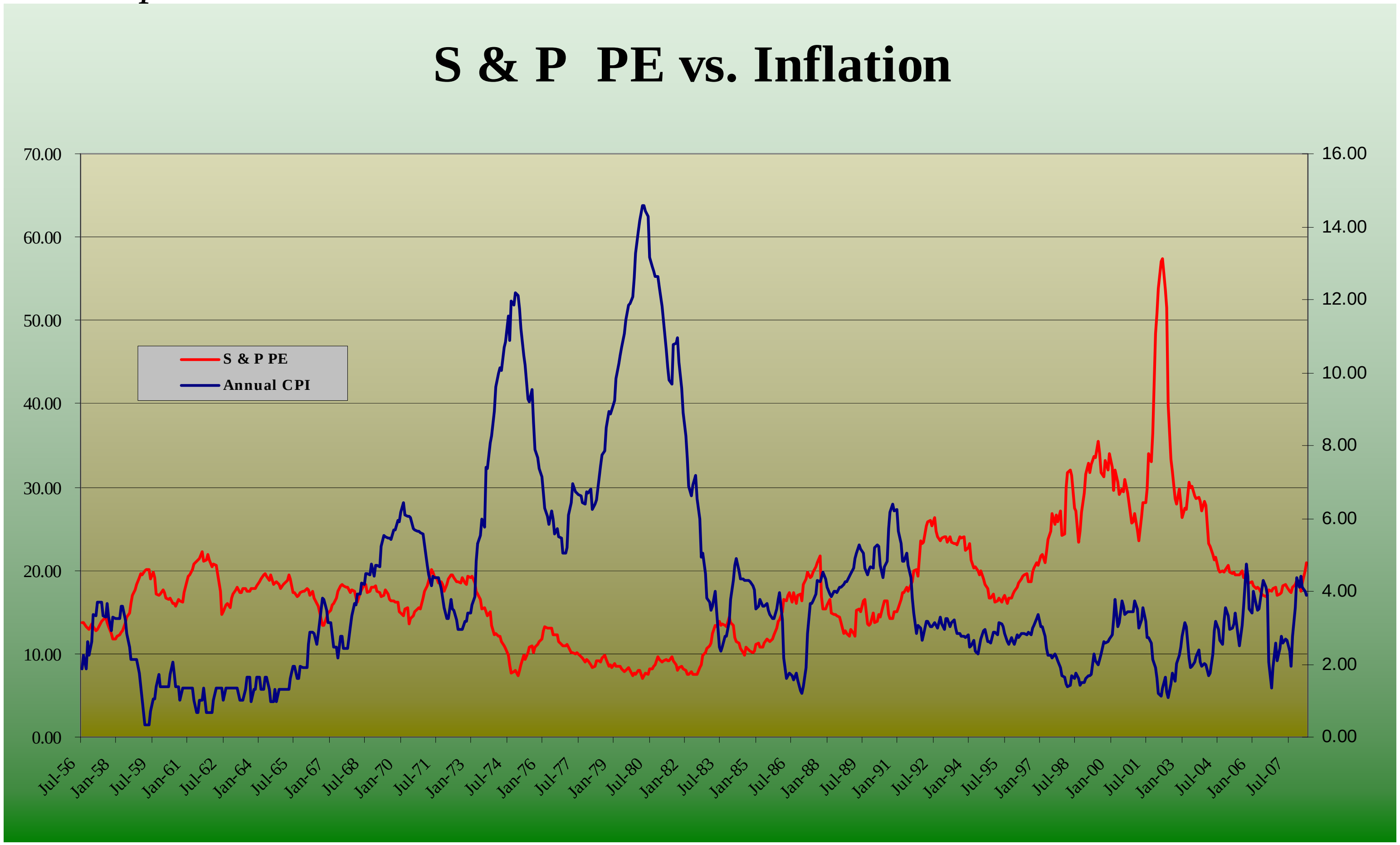
I know it is unbelievable, but long term inflation expectations remain contained.

Inflation expectations



While it isn't the 70s, the numbers are elevated and the hawks on the Fed are squawking.

Inflation expectations



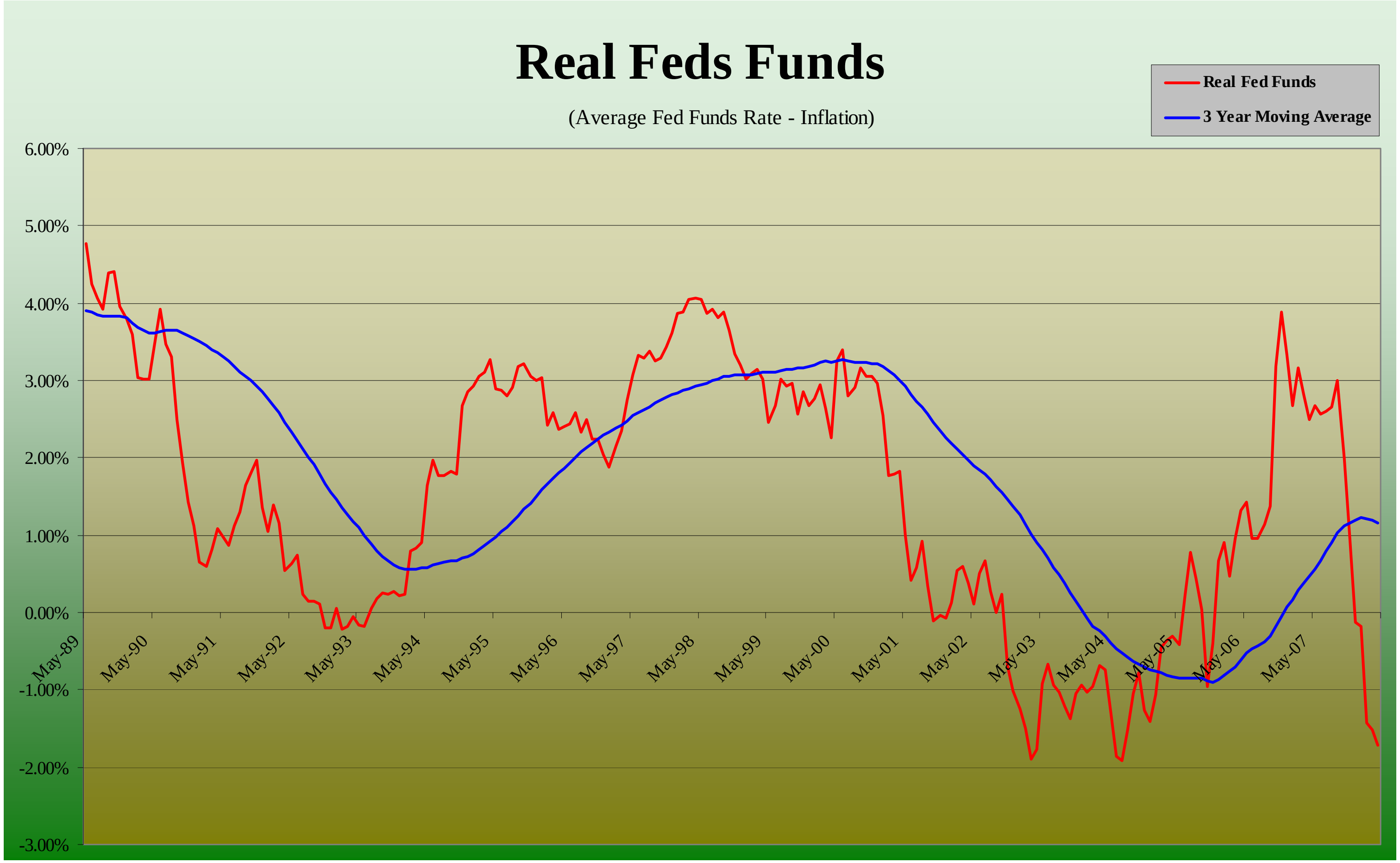
Inflation spiking higher could sink the P/E and really ruin the asset price control bubble. You think Banks are cheap today? Try them when the S&P 500 trades at 11x earnings. Ouch!

Federal Reserve Watch

The Fed needs to take back 1% of the Fed Funds Rate Cuts ASAP. Perhaps .25% in August, September, and October. If they do not, or cannot, there is no telling how high oil will go.

Pay attention to any speeches by the two dissenting voters, Plosser and Fisher. The only hope for the US$ is hawkish dissent…

Federal Reserve Watch



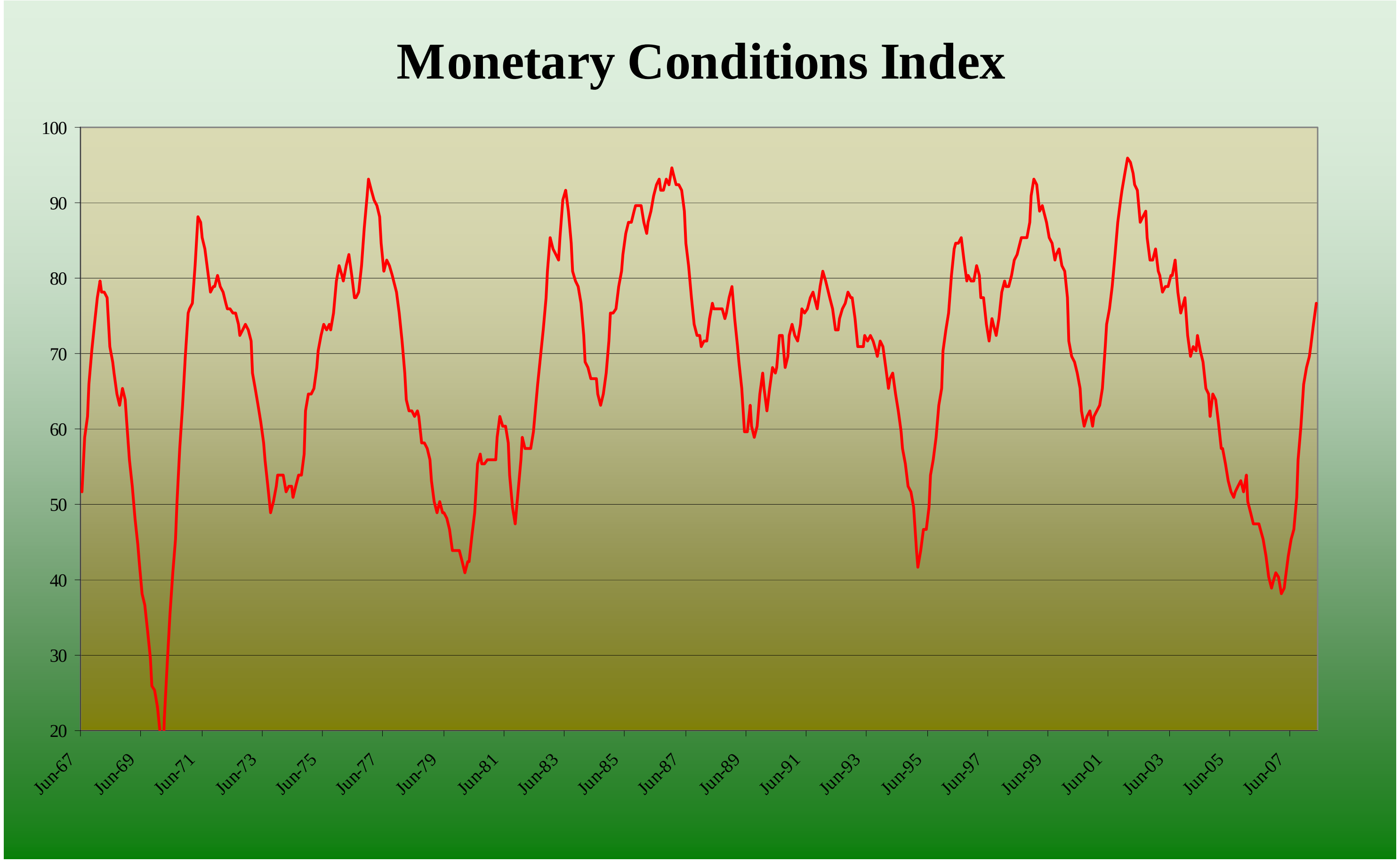
No wonder no one in the USA saves. After tax, you are really going backwards.

CORNERSTONE
Investment Management and Consulting

investwithcornerstone.com

06/17/2008

Federal Reserve Watch



Not much left. But if the dollar rallies, money will flow from commodities into stocks. It isn't so much that stocks are cheap, everything else is expensive.

The 3 month T-bill is going to need a real spread above whatever inflation really is in order to get the Gold/Oil/Dollar under control.

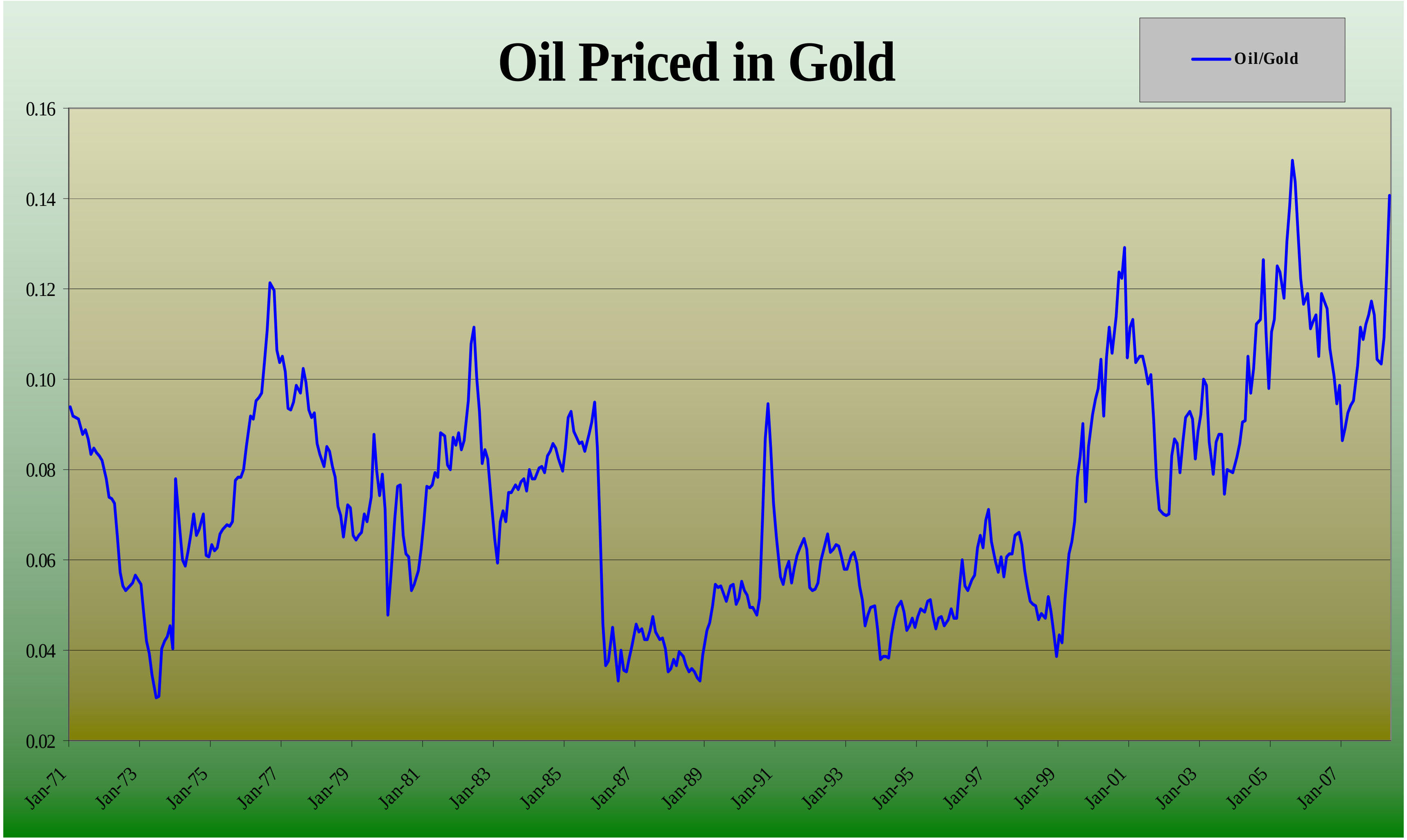
The Fed *was trying* to normalize things, and the wheels came off in the Subprime crisis. (Second Appearance)

Potential Outlook

Range bound seems the most likely course, but the street has been rallying on “less bad” news.

The US$, Gold and then Oil are key factors in the BRIC’s success over the last couple of years. A bout of dollar strength (even if it is because that is the path of least resistance) might make the commodities complex cool off a bit.

Outlook

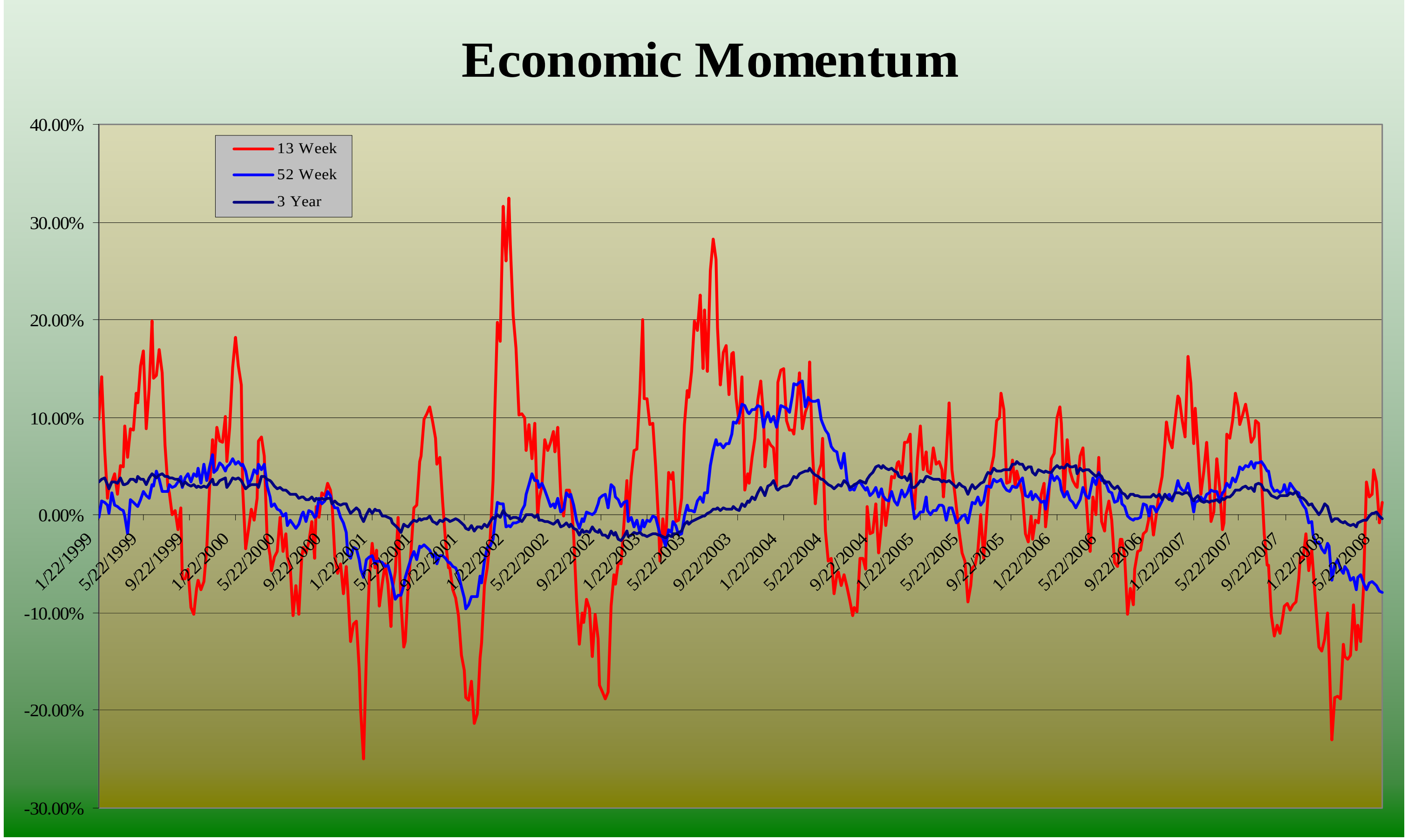


CORNERSTONE
Investment Management and Consulting

invest*with*cornerstone.com

06/17/2008

Outlook



Too soon for the all clear, but perhaps the worst of the crisis aspect is over.

For More Information:

Contact us:
Mark E. Davidson, CFA – mdavidson@csimac.com
Scott M. Koser, CFA – skoser@csimac.com
251-626-6292

Please visit us on the web at invest***with***cornerstone.com

Today's presentation is available at
http://www.csimac.com/rotary.pdf