alpha+ capital management

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Dear client,

The markets for stocks, real estate and debt have been weak and should continue that way for awhile. We are weathering through a bear stock market which so far has lasted several months and is down 20% from the peak last October. These down waves have averaged a negative 30% over the past 60 years and have gone a good deal further on occasion.

The economic system is coping with damage done by serious excess in the use of credit by numerous large investment institutions and hedge funds. Many such risk takers have sustained losses large enough to threaten their competitive status and they are liquidating assets and reaching out to new money sources such as in China and the Middle East. This turbulent reality is being processed by the market while also accounting for the economy, domestic politics and war. The sudden revelation of that much vulnerability may account for everyone's dour mood.

The DJI stocks went down 14%% in the first half and the S&P 500 index dropped by 13%. Investment grade short term corporate bonds had positive returns of 1%, intermediate US government bonds 2%, and inflation protection bonds 3%. Your portfolio had a negative return of less than one percent in the June quarter and negative 3% for the six months to June 30. The return for the June 2008 fiscal year was a positive 1.8% before fees and 1.4% after fees.

We will be better informed after the specifics of the current upset are unearthed, but some of the more interesting questions are:

1) Does some hedge fund have a parasitic relationship with the markets in which they do business and should they be allowed to borrow so much money that their failure threatens the stability of the economy itself?

2) Should our system allow flows of money from financial players to be directed into commodities like foodstuffs, oil and industrial materials for investment purposes?

3) Is there a need for modernization of governance of real estate finance, commercial banking, investment banking and insurance?

So far the level of cooperation and competence displayed by the principal government and industry decision makers has been comforting but the political posturing season is upon us and things could get less intelligent. The press and much of the public seem to have accepted the notion that these are hard times even though unemployment has just gotten to 5.5%. The figures demonstrate resilience considering the shrinking of the construction, real estate, financial and auto industries but the past suggests unemployment will move higher for say, a year or so.

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Strong sectors are agriculture, energy and exports which are benefiting from competitive US labor costs, the discounted dollar and world demand for manufactures and raw materials. The oft predicted recession should have induced many business decision makers to hold inventory and expansion plans to conservative levels. A surge in capital spending would be the appropriate sparkplug.

Looking across the next two years we can expect much of the badly financed real estate will have gotten through foreclosure and is either boarded up or sold at a bargain price to someone with a down payment. There may be bargains also in distressed commercial real estate and we will be watching for opportunities in REITs.

The recent acceleration of inflation which elevated the dollar prices of oil, gold and real estate seemed to come out of the blue. But the probable cause is persistent easy money and low interest rates which were used to combat previous economic or financial crises for the very good purpose of trying to encourage prosperity. It’s hard to know what amount of monetary easing is the right amount but in a pinch, we tend to err on the side of generosity.

In our opinion, common stock will be the most productive investment asset over the next two to five years because it is the least inflated of the inflatable assets and is attractively priced in relation to the earning power that will be displayed as we move out of the current slowdown. Think ahead to the activities being energized by $5 gasoline: accelerated drilling of wells on land and at sea, building hundreds of nuclear power plants, making fuel efficient vehicles, developing massive shale and tar sand deposits, not to mention solar, wind, tidal, geo, bio and fusion. Lag time between then and now feels like two years but the first stage of capital spending is now.

John May