



It's the Name of the Game

As investors, we are being conditioned to accept **it**. Some economists would say we are being forced to live with **it**. Analysts and strategists say **it** is part of the daily grind...and **it** is to be expected. CAM knows that you certainly can't ignore **it**.

The "**it**", pure and simple, refers to volatility...the sharp "ups and downs" of the financial markets both here in the U.S.A. and around the world. This volatility can occur intra-day, daily or in swings that last weeks, especially after peaks are achieved and bad news or raised anxiety follows. It often has a contagious quality as well. This volatility and its bi-polar symptoms have created some breath-taking and manic-depressive swings. Aside from emotions and reversed short-term rationality, the TV commentators are often at a loss to explain the phenomenon. Volatility is all about the investor's psyche and the psychological health of the markets and this seems to be an ever-changing pulse.

Let's take a closer look, because as we begin to understand what volatility means to investing and Wall Street in general, we get at the very core of what makes the market tick; unlocking the core helps to identify the opportunities and the risks which are inherent and playing out.

Since the millennium, the U.S. stock market has experienced 31 corrections or price pullbacks of 8-15% (with a 10.2% average). This equates to almost four corrections per year over the last 8 years, or almost one correction every quarter. This frequency is important to remember so we don't conclude it to be that atypical or unusual. These corrections are more compressed in timeframe space than the corrections of the 1980's and 1990's, which took more time to consolidate/sell off...consequently, we averaged about two corrections per year back in those two decades, but they lasted longer and weren't as "efficient" or "elastic" as those corrections/rebounds in our modern era (2000-forward).

Consequently, this makes the spikes and valleys create faster betas and more of a teeter-totter (some would say rollercoaster) behavior; the intensity (with a few exceptions like 1981, '87, and '91) of the volatility seems deeper and faster now and probably can be correlated to five primary factors:

- 1) Less patience among investors;
- 2) Faster dissemination of data and news that is both accurate and inaccurate, both tending to cause more reaction and over-reaction;
- 3) The global scene...more players, more institutions and funds, including hedge funds and ETFs (creating 10 times more volume than a decade ago);
- 4) Computerized trading among a larger volume of investors (triggered trading is up and often irrational); and
- 5) Many “baby boomers” are realigning/changing their objectives and creating more transactions, taking advantage of favorable taxation rates on long-term capital gains and planning for retirement or wealth transfer.

The volatility is relative, though. For example, a 200-300 point pop or drop for the Dow today seems like a big number, but in the context of a 13,500 DJIA, it is a 1.8 to 2.0% move. Not a hiccup, but more and more commonplace. Back in Oct. 1987, a 500-point drop represented a whopping 21% of the Dow (ouch!). Therefore, it is indeed relative and important to keep the numbers in perspective. Remember, when Google moves \$17 in a day, it's like a \$70 stock moving \$1.70 or a \$35 stock moving 85¢. Individual stocks can be extremely active (trading volume-wise) and jumpy (up and down) as there are more short-term traders/hackers/"shorters" in the marketplace today. On any given day this group (which includes day-traders) can account for 10-12% of daily volume, but on Triple-witching Fridays (option expiration date and x-dates for high yield stocks) this 10% can jump to 20-25%...this certainly impacts the market and is something CAM is well aware of.

Remember too that we are being geared to think short-short-term. The quick “get rich” schemes are often deceiving and most financial TV shows zoom in on minute-to-minute up and down ticks...too microscopic, perhaps, but a sign of the times. In terms of real performance, I am not always sure why investors don't consider taxation when trading. Short-term investors take gains and losses as they react with knee-jerk reflexes, but they often forget that after taxes, their real “take-home” is only 40 to 50% of the short-term gain. Those that follow entertaining gurus like Cramer can find him both knowledgeable and amusing, but if you plotted each of his picks this year, you would be losing money

(he's negative YTD). Even the once glorified hedge funds are in trouble, and they are often known for "playing fast hands" in options and straddles and taking on high risk in a fast-paced world that they perpetuate. The average hedge fund in America was down 29% YTD as of 9/30/07 and the average REIT Fund (real estate) was off even more than that, with many funds of both categories refusing to permit redemptions until 2008. It's unsettling enough to learn that your investment has depreciated 40% and that you can't even get that 60% that's left for months. The re-pricing of mortgages and real estate has sent a shockwave into declining values and is adding to the anxiety factor.

Thus at any given time, the financial markets are grappling with some unknowns that cause anxiety and create selling and buying swings. Sometimes the "yo-yo" effect occurs almost daily. Good news (like the recent bullish job report) is offset the next day by bad news from Merrill Lynch and Citicorp. Only 6 weeks before, Bear Stearns and Bank of America and UBS were the culprits. Many pundits believe that Wall Street does get upset and hold grudges, and they can be punishing if disappointed. Just look at the steep price declines of Citicorp and Merrill Lynch. We all know examples of this. However, to sum this up, the market is in a "funk", and the recent depressed mood is being caused by fallout and fear in the financial/housing sectors. There is no quick resolution, but it will eventually be ironed out.



Move Over Roller Coaster...

Over the past few weeks we have witnessed the DJIA drop 183 points in the morning, only to reverse itself (by 300 points) and finish up 118 points. Other days have been straight down with the last hour (3pm to 4pm) being the steepest crush; followed by a rally that erased the loss on the next day, only to sell off 340 points the day after. In the course of three weeks, we have had up and down cumulative swings of 1,380 points per week, but the net-net effect has been -956 points on the Dow, as bad news, good news and no real "new" news created a back-and-forth vacillation. The "up" days have demonstrated the greatest volume and widest breadth (an underlying bullish indicator of a "V" back and fill pattern). The non-performers on the "up" days are clearly in the

“doghouse” category and should be sold on any up tick; CAM is doing this. The biggest winners (stocks that have outperformed) are often the most volatile, as the short-term traders and hedge funds like to play the roller coaster ride and normal investors who need money prefer to sell winners. The classic “momentum” buying or selling gathers inertia throughout the day. If PCU starts up 2 to 3 points in the first half-hour of trading, it often climbs 7 points (approximately) that day, and the reverse can be true as well (that’s a 5% move). Throw in an x-date for its hefty dividend or “triple witching” and you create even more “spring” in the price. What all smart investors will remember are these poignant facts for **PCU**:

- AA+ balance sheet (improved from A)
- Growing dividend (four 20% increases over last 3 years)
- Low P/E valuation (underscoring “reasonable” status)
- EPS momentum is a bullish propeller (32-36% EPS expansion)
- Volatility comes from uncontrollable variables; strikes/accidents at mines can limit production output, and price of copper as a commodity will and does jump around.
- The underlying demand for copper is an overwhelming driver that will overrule the volatility in the end.
- The price back-off is a healthy part of a constructive, upward bull market; it is necessary and expected...the pause will refresh.



Half Full or Half Empty?

Central View: Mid-cycle pause and recovery has been thrown off course by financial turbulence; the credit crunch and liquidity crisis (housing market downturn) is worse than originally thought. Exacerbating the situation are higher inflation (not just oil, but raw materials and metals too), a weaker U.S. dollar, and an overall slowdown in corporate

and consumer spending that pales in comparison to the robust economies of Brazil, China and India. Stay “light” in financial/lending/insurance/housing sector investments, but some are very undervalued and may soon be “Buys” for the long-term investor. The “turn” is in sight. Banking acquisitions slow even more and new IPO offerings continue to “dry up” in this country. The winning investment theme continues to be large-cap companies with global reach and penetration in the lustrous sectors. The buoyant demands from overseas continue to fuel growth. Couple this stellar group with “special niche” opportunities (i.e. Precision Castparts, Research in Motion, Apple Computer, Terra Nitrogen and other consumer and health care companies with special appeal and EPS momentum) which are fundamentally sound and in favor, and you have some true winners. Natural resources, finished and raw materials and commodities remain scarce and in a favorable demand/supply position, underscoring the continued bullish trend in these kinds of industries.

The fix is not a quick repair job:

1) Most large-cap corporate balance sheets are solidly adequate and will weather the financial turbulence thrown at them. Expect irregularities though, especially in cash flow and dividends. It’s simply a sign of the times and the way corporate America must manage the situation. 83% of S&P 500 companies grade BAA or better.

2) The Fed will continue to infuse liquidity and keep rates from being too high. The tighter bank lending conditions are a “given” and the fallout and defaults will continue for the next four Quarters, but the U.S. dodges a recession and experiences a soft landing (-2 to +2% GDP). Interest rates will stay flat...no likely cut in Dec (tip-off: watch January...) spillage into general economy is scant so far, according to Bernanke.

P/E valuations remain attractive, both vs. historical standards and for future projections (15.8x cries out undervaluation). Earnings (even when inflated or adjusted for currency translation) always correlate to stock price movements, and CAM identifies with the best of the best.

Total Return stocks offer insulation as high dividend yields enhance performance overall and reflect the underlying cash flow strength of the company (94% of the value stocks which have increased dividend payouts for 3 consecutive years have both A balance sheets and double-digit EPS growth). CAM would like to have this “dynamic duo” working for you.

Avoid retail stocks and consumer-driven (esp. durable) sectors as they will suffer from sluggish spending and anemic profit margins. Avoid airline and certain transportation stocks that are too energy-price sensitive, hence dampening results and causing conduit problems (safety, on time and pass-along costs).

As we summarize, it is apparent that the volatility in the financial markets is signaling unsettlement and a range of views, which reflect many dynamics and crosscurrents. We can conclude that this spiky volatility will continue for some time to come, and we must equip ourselves to deal with it. Geopolitical concerns worldwide and our unfolding '08 Presidential election saga are adding some extra anxiety and uncertainty to the mix; as we know, the financial markets do not do well with unknowns. There are some bright skies on the horizon, and CAM is not painting a “doom and gloom” picture. Obviously, there are winners and losers, and we know the difference.

CAM will remain vigilant, alert and attentive to the unfolding developments and steer investors in the right and safest direction. We wish everyone a wonderful Thanksgiving Season.



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