



ON COURSE A QUARTERLY NEWSLETTER FROM GEOVEST ADVISORS

A Little More Patience

We are having a good year. For most accounts, our performance is better than the market despite maintaining hedges in our portfolios to protect against a downdraft in the market.

The market, in general, is having a difficult year. The Dow Jones Industrial Average and the Nasdaq Composite are both down for the year, while the S&P 500 is down slightly. If you've read our previous newsletters, you already know the reasons – the global economy is weakening.

Our forecasting of the economy has been outstanding, and we believe that we've structured our portfolios in the best possible way to take advantage of economic weakness.

The chart of the Dow Jones Industrial Average, that we've provided on the top of the next column shows how the market goes up and down. This means that over the course of a 10 year cycle, clients should expect our investment strategies to be positive, negative, and neutral when the time is appropriate for each.

Presently, we have a negative bias and we've been right. This negative bias is temporary as it will change when new



Source: Stockcharts.com

opportunities are available. The investors who are willing to wait for those opportunities will make money, while the impatient investor will likely lose money.

Sometimes it takes a year or two before you see the results of the decisions we make. Two years ago, we sold all the bonds of Ford and General Motors in client accounts. At the time, we forecasted a decline in credit quality due to the aggressive financing options that they were offering to customers. In early October, the bond rating agencies lowered Ford's bonds to "junk" status, and GM's bonds were reduced to one step above "junk." Investors who owned these bonds lost money.

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Special points of interest:

- We are optimistic about the next few years.
- Changes in the global economy favor GeoVest's disciplined approach to investing.
- Interest rates are probably close to their near term lows.

We are Optimistic

We believe in the old saying that the market swings back and forth between greed and fear. Sure, that sounds bad, but there is a lot of money to be made during times of fear if you are a rational investor. As rational investors, we've taken precautions in your portfolios to protect your accounts from a potential downdraft in the market. But, that's not why we're optimistic.

Our optimism stems from our perception that the market is about to transition into a cycle that will take advantage of GeoVest's core strengths – our focus on international economics and our strong valuation disciplines.

In our view, it is likely that international problems over the next few years will catch a lot of investors unprepared. Some of those problems may include weakness in China, Japan, and South Korea, social change in Europe due to changes in the makeup of their populations, and barriers to trade in the US in reaction to our weakening jobs market.

Sure these changes sound ominous but remember one very important thing – when money exits one place it flows to another. Money doesn't go away, it just seeks higher returns. We're in the process of anticipating where those higher returns will be, and how we can invest in them to make money for our clients.

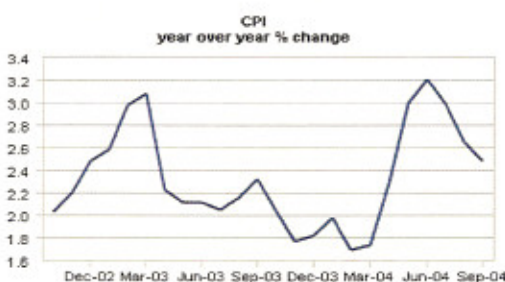
It looks like inflation

We employ a discipline at GeoVest where we try to find anecdotal evidence to either support or contrast reported government economic data. That way we can be sure that the government's notoriously volatile measurements actually reflect the reality that we perceive as consumers. Today, there is a divergence in that reality.

Try to buy a house, or fill your gas tank, or

simply buy milk and eggs, and you see higher prices. The only places where you see prices falling are at your local Wal-Mart or furniture store where they import goods from Asia. The problem is that you can't eat a couch that's been marked down 50%.

Notice the chart below of the consumer price index, the government's main measure of price changes in this country. This chart would lead you to believe that we are experiencing subdued price increases in this country, yet those of us who shop, fill up the gas tank, or pay monthly bills know that prices are rising.



Source: Economy.com

Now, before you start to question the sanity of government statisticians, it is helpful to add that they, as a group, are very bright people. Also consider that we've just ended a decade of extraordinary improvements in all aspects of our lives from the quality of food to the speed of computers to the durability of cars. Instead of just allowing us to make up our own minds regarding the value of these quality improvements, the government statisticians have tried to quantify these changes. The result, in my opinion, is a measurement that is no longer a useful gauge of inflation in our country.

So what difference does it make? The answer is that it results in overstated economic growth and corporate earnings. When the market wakes up to higher inflation, interest rates will rise and hurt future growth in the economy.

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The Interest Rate Conundrum

As we discussed in the last newsletter, forecasting interest rates is currently very difficult. To our credit, we've gotten it right up to this point, but we are not resting on our laurels. Given the higher level of inflation than implied by the consumer price index, the easy decision would be to position our portfolios to take advantage of higher interest rates. This would be the case if the markets were free to trade without government involvement, but they are not.

Asia is running an enormous trade surplus with the United States. This means that we buy more from them than they buy from us. Normally, when this happens, the value of the dollar would fall as Asian companies convert dollars back into their home currencies. This would make it more expensive for Americans to buy Asian goods. The difference today is that the economic policies of every Asian nation revolves around exporting more than they import, and the only way to facilitate this policy is to maintain a strong dollar.

Notice the chart of the Current Account Deficit. Currently, we are at a run rate of \$600 billion per year that the Asians are supplying us so we can continue consuming their goods. Think of it as vendor financing.

Here's where forecasting interest rates gets tricky. When the Asians use their excess dollars to buy US Treasury Bonds, they artificially drives down interest rates. On the surface, this sounds great because when interest rates fall, we can buy more cheap goods from Asia. Unfortunately, there is such a thing as too much of a good thing. In our case, we've basically hit our limits on the amount of debt we can service without corresponding gains in income.

Here's a chart of the US dollar versus a basket of other foreign currencies. You can see how the dollar is falling pretty rapidly. This is an indication that foreigners no longer want to own dollar denominated assets.



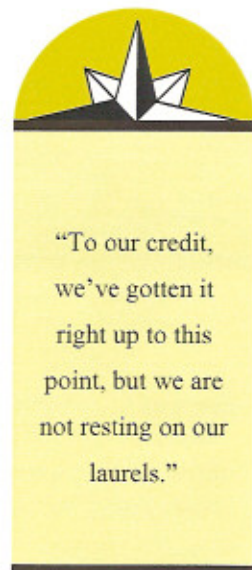
Source: Stockcharts.com

Our economy is weakening because the current President and the prior President adopted strong dollar policies that encourage consumption over production. This policy made it possible for our Asian trading partners to run the massive trade surpluses with the United States that has resulted in a shift in manufacturing jobs from the US to Asia.

Balance on Current Account
Bil. \$, SA



Source: Economy.com





We are currently working on upgrading our website to add functionality and content. We are very excited about the possibility of giving you more timely reports on our expectations for the market and the economy.

What are we going to do?

We're going to be patient a little longer. Changes in the market create great opportunity and we are diligently preparing for that opportunity. The key is to have capital available to take advantage of opportunity when it presents itself.

Remember, making money in the stock market is a long term commitment. Warren Buffet, who is arguably the greatest investor of the late 20th century and early 21st century, attributes the ability to be patient as one of the necessary skills for making money in the stock market.

We're excited about the opportunities

The GeoVest Approach

to successfully employ our client's capital over the next few years and we would like to discuss these opportunities with you. If this newsletter has sparked some ideas or just raised some questions, we want to hear them. And, as always, if there are ways we can better serve you, please let us know.

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