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## Fourth Quarter Newsletter

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### Tax Reminder for 2007

Don't forget to contribute the maximum amount to retirement plans before April 15 to reduce your taxes for 2007. In addition to employer-sponsored plans, you may be eligible for self-employment tax deferred retirement plan if you have income from work outside your main job. You should also fully fund individual retirement accounts such as IRAs and Roth IRAs. There are income limitations with these plans, so contact us to make certain you qualify.

We also recommend that you fund your 2008 contribution as early in the year as possible to optimize compounding opportunities. Contributions limits for 2007 and 2008 are as follows:

Type of Retirement Plan	Maximum Annual Contributions			
	2007		2008	
	Under Age 50	Over Age 50	Under Age 50	Over Age 50
<b>Individual Retirement Accounts</b>				
Traditional and Roth IRA	\$4,000	\$5,000	\$5,000	\$6,000
<b>Employer-Sponsored Retirement Plans</b>				
401(k), Roth 401(k), 403(b), 457 and SARSEP Plans	\$15,500	\$20,500	\$15,500	\$20,500
<b>Small Business or Self-Employed Retirement Plans</b>				
Self-Employed 401k (a.k.a., Solo-401k, Individual 401k, Roth 401k)	100% of compensation up to \$15,500	100% of compensation up to \$20,500	100% of compensation up to \$15,500	100% of compensation up to \$20,500
SIMPLE (Savings Incentive Match Plan for Employees) IRA or 401(k)	\$10,500	\$13,000	\$10,500	\$13,000
<b>Coverdell Education Savings Account*</b>				
Per beneficiary under age 18	\$2,000		\$2,000	



**“Emotions play a very important role in life....The challenge for investors is to remove emotion from the investment process as much as possible.”**

## Emotion and the Investor

Volatility made the past year a difficult one for investors. With every fall or upward move in the market, we were treated to a host of financial experts proclaiming either ongoing doom or the resurgence of the bull market. If there was one prevailing emotion for investors in 2007, it was fear. Fear of losing money, and fear of missing out on opportunities to rebuild portfolios that were still feeling the pain of the 2000-2002 market decline.

Behind that fear were a number of very reasonable concerns ranging from the housing market to the sub-prime lending debacle, energy prices, consumer indebtedness, inflation and more.

The problem with fear, however, and for that matter any emotion, is that it makes a lousy investor.

One of the latest studies of the mental processes of successful investors is a field called Neuroeconomics that explores the role biology plays in economic decision making, by combining insights from cognitive neuroscience, psychology and economics. Among the neuroeconomists' recent work was an interesting study in 2005 that looked at the investing success of individuals who had suffered damage to the region of the brain that controls emotions, inhibiting their ability to experience basic feelings such as fear or anxiety. The researchers' conclusion: the individuals' lack of emotional responsiveness actually gave them an advantage when playing investment games.

A different side of the emotional spectrum comes into play when individuals invest for the pleasure of winning. When small wins no longer bring the same jolt of pleasure, the investor ups the ante, risking increasingly larger amounts to regain the pleasurable experience of winning.

Behavioral finance theorists are also quick to point to emotions as the reason many investors sabotage their own financial success. Among the common mental mistakes identified by behavioral finance is allowing emotional connections to over-ride reason.

With that said, emotions play a very important role in life. Researchers in the study of the brain-damaged individuals found a lack of fear resulted in a much higher level of trust in the good intentions of others, often to the detriment of the individual.

The challenge for investors is to remove emotion from the investment process as much as possible. That starts with recognizing that we are vulnerable to emotions and that those emotions can make us act counter to what is good for us. The next step is to set up rules that help remove emotion as much as possible from the decision process.

In our management of client assets, we do this through quantitative decision models that depend on mathematics and trend analysis rather

than subjective judgments. We let the market tell us what is happening rather than trying to impose an emotional decision that may not necessarily be based on facts.

For investors who are able to do the same with their portfolios, this is a good way to go. But not everyone operates along those lines. That's when using a good investment manager is invaluable.

An investment manager typically has several advantages over the individual when it comes to managing assets. Expertise and time are two key advantages. A good money manager has spent years studying financial markets, developing investment approaches and backtesting them prior to investing to understand the strengths and vulnerabilities of the approaches. The manager also invests on a full-time basis. In today's fast moving markets, this can be a distinct advantage.

A professional manager should also have the benefit of emotional distance. While a registered investment advisor has a fiduciary obligation to act in the client's best interest, it's not his money. While that sounds a bit callous, it also helps the manager put losses and gains in perspective. Yes, the manager wants the client to do well, but setbacks and gains tend to stay in perspective of long-term goals. By keeping emotion at a minimum in the investing decision, the manager is in a better position to make good buy and sell decisions.

## Fourth Quarter 2007 Securities Markets Commentary

Concerns over the market's direction and economic growth for 2008 is evident. The third quarter of 2007 ended with questions and psychological effects on the market as a direct result of multiple factors: war and the developing government in Iraq; oil rising to \$99.29 per barrel in December; increasing commodity prices; escalating inflationary pressure, particularly impacting the domestic securities market; anticipation of future domestic tax policies and investment strategies in accordance with the upcoming presidential election; and drops in a few of the more widely followed indexes - Dow, NASDAQ and S&P 500.

The fourth quarter proved to be full of surprises: strong November sales for retailers, increasing mortgage delinquencies, weak December sales from popular chains, and inflation expectations. The Investors Group Inc. (2007) states that the most noted successful markets and sectors include: energy, industrials, and limited materials, while financial and consumer discretionary stocks declined. The Federal Reserve shifted its focus early in the fourth quarter, in an effort to stimulate the economy by creating rate reductions that would position the last quarter of the year for economic expansion. One must not neglect to comment on the nation's total bank credit of approximately \$9 trillion as of October 2007; when expanding the view of credit issuers the final sum appears to be closer to \$30 trillion or more once credit from bond issuance and foreign investment totals are tallied. An optimistic view fortunately provides that a loss, whether of \$50 or \$250 billion in the credit market, would not even equal 1% of the total available credit; additionally, this number will be greatly reduced upon recovery of assets from sub-prime borrowers and sale of subsequent collateral and equity.

At this point, bad news is good news for the nation's economic cycle; the negative outlooks have spurred the Fed to stay active, especially concerning an accommodating interest rate policy, in an effort to avoid recession and to create an environment for significant economic development. While all of this data increases the market's positive outlook, the most favorable national change is the Fed's aggressive reduction of interest rates that affected many of the market's sectors favorably, resulting in noteworthy gains, a drastic change from the sub-prime fallout that put a dent in the third quarter.

The economic concern over the price of crude oil has continued to be a focus among many economists as the product acts both as a tax against domestic productivity as well as an inflationary pressure. The early part of 2007 showed crude oil prices at \$50 and \$60 per barrel, but by October, they had risen to \$92 and in December the commodity nearly reached \$100, forecasting a grim future.

International positions have been aided by the falling US dollar and the US Census Bureau and the U.S. Bureau of Economic Analysis, through the Department of Commerce, announced December 12, that "total October exports of \$141.7 billion and imports of \$199.5 billion resulted in a goods and services deficit of \$57.8 billion" notes the United States Census Bureau (2007, p.1). Interestingly, the falling Dollar is helping to spark interest by foreign investors making US goods and services more cost effective and therefore helping to reduce the gap in the trade deficit.

As 2007 proved to be a volatile yet productive year, we are anticipating more of the same in 2008. The markets will continue to worry about foreign and domestic issues alike as the media is in constant search of world conflict and political party shenanigans. The election cycle will undoubtedly provide plenty of twists and turns as candidates vacillate between confidence and desperate TV messages that often prove to be uninspiring. The Fed will need to continue to weigh inflationary pressures from commodity prices against the recessionary signs of the home building and mortgage industries. Although, we believe the Fed may be forced to focus on rescuing the economy rather than playing a balancing act. While we anticipate a difficult year in which to be productive, usually there are bright spots that provide opportunities for profit. We look forward to those opportunities and feel confident that we will be positioned well when those opportunities arise.

As always we will not have all the answers in 2008, but careful analysis of prices and trends could offer insight into the market's future prognosis. Our investment analysis, however, is not infallible and, therefore, does not assure positive results. When the market and its investors are unsure about future prices and trends, the market tends to be stagnant or even decline as a result of the pessimism. Models do not guarantee investment gains in an environment that does not offer sustainable price movement in the securities market. However, these models will continue to seek investments that are performing well, and as new trends emerge, the models will continue to seek investments that perform well and allocate assets in those areas. It is important to realize that modeling is not intended to time the markets or trade short-term micro cycles. Rather, this strategy attempts to identify changes in market direction, industry, and sector price behavior in an effort to participate in long term trends.

## Appealing Property Taxes

One of the first rules of accumulating wealth is to not pay any more in taxes than you are legally obligated to do. Which brings up the issue of property taxes.

Falling real estate values in many areas of the U.S. could mean your property tax assessment is too high. Because lower valuations will mean a big hit for county revenues, you may also find your county assessor's office slower at lowering appraised values than it has been at raising them over the past few years.

Appealing a tax assessment starts with the question of whether or not your home has been valued fairly and if it is classified properly. A residential property is going to be taxed at a lower rate than a commercial property. Agricultural properties are lower yet. The best place to start is typically by looking at the sales prices of comparable properties at the time your assessment was made and double checking how those properties are classified. For a list of sales in your area over the past two years, visit the office or website of your local county property appraiser or tax assessor. If you have recently received your 2008 appraised value, the county will often include a list of comparable properties it considered in determining your valuation.

When comparing values, look at the size of the homes, lot size and the average assessed value per square foot. You also need to consider type of construction and amenities. If your property's value seems out of line, there's a chance you can lower your property tax bill by appealing the assessment. But make certain you follow the proper procedures to avoid wasting time.

To appeal your assessment, contact your county assessor's office for information on the appeal process and the proper forms. Ask questions when you call, but don't get defensive. Sometimes a friendly conversation can resolve the problem quickly without going through the formal appeal process.

If there are particular circumstances that make the county's valuation too high, you may want to consider hiring an appraiser to provide a professional assessment of your property's value. Because many counties now use computerized programs to arrive at assessed values, it can be difficult to dispute a valuation when special factors come into play without a professional's opinion.

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## Lessons from the Sub-Prime Crisis

The sub-prime lending crisis currently impacting the financial markets is also a primer in investment basics that we as individuals would do well to remember.

### Markets are not efficient.

The efficient market theory requires that market participants have rational expectations; that on average, the population is correct (even if no one person is) and whenever new relevant information appears, investors update their expectations appropriately. The problem is that at market extremes and irrational behavior is often the norm. Late stages of a bull market are driven by buyers who take little notice of underlying value. As the market collapses, investors sell positions regardless of the value that their investments represent.

### The pursuit of excessive returns involves higher levels of risk.

Risk is the potential that an investment will lose money. Everyone who purchased a home with adjustable rate mortgages, zero-down mortgages, interest only balloon mortgages, inaccurate financial data, etc. took on the risks that housing prices would not continue double-digit gains and interest rates could increase. Every investor that purchased mortgage-backed securities based on these mortgages assumed the same risks. Many investors compounded that risk by using leverage to further enhance their returns.

Bubbles collapse. They always have and always will because the market cannot sustain excessive returns indefinitely. The fact that the Federal Reserve is in the process of bailing out these investors through lower interest rates raises the concern that investors will not learn from the experience. But then again, they don't appear to have learned from prior bubbles, either.

### Supply and demand are the ultimate determinants of value.

Many of the mortgage-backed securities that are now trading at a fraction of their prior value still have real value. A majority may eventually be paid in full. But demand has disappeared at the same time supply increased as many investors are forced to sell their positions. As a result prices have tumbled creating a new opportunity for those with the cash and wherewithal to accurately evaluate these investments. But the players with cash are not the ones who take excessive risk.

### History has lessons that matter today.

Included in every investment prospectus, ad and performance report are a variation of the words, "Past performance is not indicative of future returns." While there is plenty of truth to that statement, the past still provides us with clues to the future because what has not changed is human nature. There's an entire field of study called behavioral finance that looks at how people react to different situations in the financial markets. Behavioral finance and other fields of research have proved that patterns repeat.

We would all do well to remember the lessons of history in our own investments. Nothing goes straight up forever; there are always corrections along the way. Any asset which gets priced in a free market tends to be impacted by variations in other assets in that market. Every investment has the potential for loss as well as gain.

As an investment advisor, one of our hardest jobs is often explaining why investing in the top performing mutual fund, the hot sector, or latest greatest investment may be okay for a portion of the portfolio but not to the extent that a loss will jeopardize the individual's financial future. The relationship of risk and return is not just a theory.



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### Making People's Lives Better

As an ever growing organization, we find that we must, from time to time, scour our industry for the best talent we can find. To that end, we'd like to introduce you to our newest team member, Gail Wells.

Gail joins us after an extensive career with another very respected and substantial Registered Investment Advisory firm. She brings with her a breadth of knowledge on client deliverables, such as service and planning as well as an integrated problem-solving approach. In the short time she's been with us, we've already experienced the incredible synergy she brings to our team. We're very excited to have her and feel blessed that she chose CIMCO for her future.

Gail currently lives in Centennial, Colorado with her son, Bryon, who is a senior at Arapahoe High School. She also has a daughter, Laura, who currently lives in New Mexico and is engaged to be married this summer. She enjoys skiing, gardening and the Colorado outdoors.

We hope you agree, as you have an opportunity to meet her, that she truly is an asset to our CIMCO team.

## CAPITAL INVESTMENT MANAGEMENT

*Registered Investment Advisor*

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