

**Capital Investment Management's
Client Conference Call, December 6, 2008 9:00 a.m. RMT**

So, the NBER (National Bureau of Economic Research) finally made the call this Monday that we are in a recession! (Something you and I have known for months). This recession is believed to have started in Oct/Nov of last year (source:<http://wwwdev.nber.org/cycles/doc2008.html>). By the way, the day this was announced, the US Stock Market indexes took a dive, the Dow ended down Monday, 679 points, or 7.70% (source: quote.yahoo.com).

A recession, officially, is a decline in the GDP for two or more consecutive quarters. There is (just in case you're curious) no standard definition for a depression, but the best that may be offered in that vain is that a depression is a recession that lasts longer and has a larger decline in business activity – sometimes a GDP decline by more than ten percent! The last depression was May 1937 to June 1938 where real GDP declined by 18.20%. Prior to this was the Great Depression: August 1929 to March 1933 GDP declined by almost 33%. And, a more recent memory was November 1973 to March 1975 when we saw a decline of 4.9% in comparison (source:<http://economics.about.com/cs/businesscycles/a/depressions.htm>).

So, what do we believe we are in? Certainly (obviously) in a recession, but the likelihood of an economic contraction (meaning greater than 10%) may be avoided.

What caused this mess?

We could simplify a very complex, and convoluted, answer with a couple of words: leverage and greed.

After what Greenspan called “irrational exuberance” at a speech given at the American Enterprise Institute (by the way, given on Dec 5th 1996) and the bursting of the internet bubble in 2000, followed by the tragic events of 9/11/2001, interest rates were aggressively dropped to stimulate consumer spending.

There was another aggressive move made in the late 1990s to increase home ownership by legislative action – a decreasing “standard” on lending, coupled with a low interest rate environment, had an unintended consequence...a real estate bubble manifested. We could play a blame game in the real estate bubble – was it the realtor that sold more home than the consumer could technically afford (to earn a higher commission)? Or the mortgage broker who could make the home affordable by putting the consumer in an ARM with no down payment required (also earning a higher commission, with the potential for a second transaction in 3-5 years)? Or the bank that would buy these mortgages (creating a market)? Or Wall Street who would take those mortgages, create tranches and esoteric vehicles to lever the yield and sell them to unknowing pensions and institutions? Or the consumer (caveat emptor) who believed they could afford a home 5x their salary?

On a side note, there has always been economic chatter about a concept known as decoupling – whereby, international markets would demonstrate some measure of “immunity” from the US economy. Not quite the case this year. International economies, and as a result, Internat’l Equity Markets have also suffered – more dramatically since the peak in Oct. 2007.

Who’s getting hit the hardest?

In short, everyone. If you would have asked me in the beginning of this year if Lehman Brothers would blow up, I may have given a different answer. The names are well known, and staggering: Lehman, Wachovia, Merrill bought by Bank of Amer, the shotgun merger of Bear Stearns with JP Morgan, etc. etc. Bailouts, the TARP (or the Economic Relief Plan), now potentially the Big 3. Corporate earnings have also slowed down dramatically and will continue to do so as consumers deleverage their own personal balance sheets. Bonds, corporate, gov’t, and muni’s, are also a difficult environment – with declining property values, incomes, and capital gains, tax receipts are down significantly. Case in point is California; which at last count, would run out of money in March if budget cuts and new money isn’t raised. (Calif. Treasurer John Chiang said state’s cash account will decline to \$882 million in Feb and be -1.9 billion in March).

Undoubtedly, however, it is the consumer and investor who is experiencing the most pain. What do we anticipate in the next six to nine months, and in the next twelve plus months?

First let’s discuss the shorter term:

With Friday’s news of job loss reaching over 533,000 in November, it pushes the year over year unemployment number to 1.9 million, or 6.7%.

We would anticipate that although with a strong Black Friday and weak remainder of the season, we would expect corporate profits to continue to be nominal, possibly even negative. (We may see volume, but without much margin, as corporations will want to decrease inventory).

As a function of diminished corporate profits, we would expect that the private sector may push unemployment to 8 or 8.5% by mid to end of the third quarter 2009.

There’s also a wild card left to be dealt – the resolution around the Big 3, which has the potential to push an additional 1 to 3 million into unemployment.

The public sector (local, state, and federal gov’t’s) faced with burgeoning deficits could also be forced to let people go or raise taxes. This may provide an additional unemployment increase of 1 to 1.5%, getting us close to a double digit unemployment rate.

Home prices may also continue to correct, depending on your market.

The intermediate term, so long as the above events don't severely debilitate our economy, is a bit brighter. Inventory levels are good, numbers may begin to correct themselves, and with the low expectations on corporate earnings, profits may begin to go up. This could mean an increase in factory volumes, a bottoming of inventory, and better corporate balance sheets – all creating a catalyst for economic expansion.

This expansion, coupled with lower energy costs, and lower interest rates on consumer debt (mortgages, car loans, credit cards) may provide an opportunity for further consumer deleveraging and, most importantly, a future for increased consumer spending.

So, we've talked about the genesis of these economic issues, looked at the short and intermediate term outlooks.

Most of you are aware that we at Capital Investment Management Company have 1) Passive, or buy and hold, models – for the long term time horizons 2) Income Benefit strategies and 3) Actively traded models that tend to be more proactive/reactive in environments like this. Call us if you'd like to get details around these models, performance and outlook.

Our actively managed strategies are all hedged or in cash. All of our current signals are currently telling us to be in cash. It is our belief that since the S&P 500 broke through that support level of 850, there is a good chance that it may eventually fall to the 650 range which is roughly 25% below where it is currently trading at. The frustrating part is that markets don't just keep selling off. It is very typical to see strong rallies even during bear markets. Some analysts feel that the market will find some support at the 2002 lows which it already has. If it breaks through those lows (which we believe it will) then our scenario of S&P 500 reaching 650 becomes much more likely.

The best analogy I can come up for this current market condition is to compare it to a power line that is down after a major hurricane. It would be unwise to go up and just grab hold of it. We first need to cut the power and then we can fix it. We've cut the power by getting you out of the market. But, we need to be able to be nimble and look at how the market reacts on a day to day basis. We do not want to be caught in a scenario where our outlook for what could happen makes us blind to opportunities. Remember, stock markets begin climbing back six to twelve months before the economy does. That means that we will eventually have to get our models back in when it may not "feel" good to be in the market because the economic news is still bad. Markets and economies do not move in synch.

For the time being we extremely cautious with our models and will continue to be until our signals tells us that the markets are a bit safer.

Since we are unable to provide a question and answer portion of the call, we have chosen 2 very commonly asked questions to address in this section.

- 1) What changes, if any, should I be considering w/ my CIMCO assets and/or with my outside assets? (Discuss goal alignment.)
- 2) And, how will this impact our projections for time-to-retirement or lifestyle-in-retirement? (Regular reviews.)

Q&A w/ Ali

As Chad talked about, we make alterations in the portfolio to account for changes in the market. We don't believe that you need to make shifts in the strategy allocations. Unless, of course, your goals have changed or for that matter, your circumstances.

Another component that may warrant a shift in the strategy allocation is if the anxiety you are feeling is so extreme, we may need to reconsider the mix.

The impact will vary client by client and these have been the subject of the reviews that we have held with our clients. So, we will be re-running our projections on a client by client basis during our reviews.

Close

We want to, again, thank you for taking time on a Saturday to call in. We want to reiterate that we welcome any feedback on the call, and hope we can increase the frequency of such services. Our next event will be a breakfast "economic briefing" in January so we encourage you to attend that as well.

As always, we are humbled, honored, and deeply aware of the trust and confidence that you have placed in us. That is a responsibility we feel to the core of ourselves, and we will always strive to better enhance our systems in this incredibly challenging economic environment.

Have a wonderful rest of your Saturday and weekend!