



## Market Commentary – March 2008

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### **March 2008 Review**

While the equity markets remained in the doldrums during March, the month will be noted for the aggressive moves by the Federal Reserve to stem the economic decline brought on by the credit crisis. Indeed, the central bank was busy implementing a new loan program allowing the government to hold mortgage backed securities as collateral, approving a credit line to enable JP Morgan's acquisition of Bear Stearns, opening of lending to investment banks, and cutting the Federal Funds target rate by 75 basis points. While the longer-term impact of these actions is yet to be known, they were helpful in helping equity indexes to recover from a mid-month deficit and end about flat for March. During the month, investors continued to favor momentum and high quality. Value continued to do relatively poorly. Industry performance was strong among machinery groups with notable above average gains in agricultural machinery, railroad equipment, and industrial machinery. Notable among the weak performers were oil related industries and coal.

### **First Quarter Review**

In the first quarter of 2008, the financial markets struggled with a continuing credit crisis that appears to be the worst since the savings and loan debacle of the early 1990s. Financial stocks continued to falter almost across the board. In the face of the credit contraction, a slower economy, and declining corporate profits, the S&P 500 finished the quarter down -9.9%. Besides encouraging the buyout of Bear Stearns, the Federal Reserve lowered the federal funds rate from 4.25% to 2.25%, lowered the discount rate (the rate at which a limited number of institutions can borrow directly from the Fed) from 4.75% to 2.5%, opened the discount window to investment banks, and reduced the capital holding requirements for Fannie Mae and Freddie Mac. Fed Chairman Ben Bernanke has struggled to provide liquidity in order to encourage borrowing and lending without stimulating inflation. Oil exceeded \$100 per barrel during the quarter, and

commodities in general surged, magnifying the potentially inflationary results of Bernanke's rate cuts. High oil prices tend to encourage inflation, since they raise the cost of almost every good and service, but they also tend to depress the economy, as they soak up more and more of consumer and business spending. Therefore, observers wonder if Bernanke will be able to avert the dreaded "stagflation" (simultaneous declining growth and higher prices) of the 1970s.

### **Market Outlook**

Tower still believes that the stock market can make upward progress during the coming year. Our year end price target for the S&P 500 remains 1550. We expect decisive policy action by the Fed and Washington, the growing global economy, strong corporate cash flows and balance sheets, and very attractive valuations to offset the challenges of slowing economic and earnings growth (especially during the 1<sup>st</sup> half of the year), and weakness in the credit and housing markets.

### **Strategy Summary**

Towards the latter part of March, Tower began to adapt a less defensive strategy and begin to position the portfolio for a stock market rally that we see being driven by the economic and earnings rebound that we anticipate will begin to materialize in the upcoming May to July time period. After successfully retesting its late January intraday lows twice in March, we believe that the stock market has put in a near term bottom. After muddling through what we anticipate to be a difficult first quarter earnings reporting period, positive catalysts that should fuel the rally include the Fed cutting key interest rates on April 30<sup>th</sup> (this is likely to be the last Fed interest rate cut) and investors beginning to focus on the presidential election cycle which typically during the year of the election sees the stock market take off in May and rally into the November election.

### **Money Market and Bond Strategy**

As dislocations in the credit markets persist Tower will continue to employ highly defensive money market and bond strategies. Principal preservation and price stability will continue to take priority over yield level.

### **Stock Strategy**

Towards the latter part of March, Tower began to implement a less defensive strategy and begin to position the portfolio for a stock market rally that we anticipate beginning during the next few months. Successful stock picking themes that we will continue to emphasize include stocks that can grow earnings in a decelerating earnings environment (i.e. Multinationals, Agriculture plays, Aerospace & Defense stocks, and select Technology companies), Foreign stocks (stocks with exposure to Europe and fast growing emerging markets in Asia, Eastern Europe, and Latin America), High Quality stocks, and stocks that have high free cash flow yields. In addition we have developed a new "Ultra Low Risk" stock picking theme that looks for stocks that have low price volatility and Beta, pay a dividend ("Show Me the Money"), and possess highly visible earnings prospects.