



Quarterly COMMENTARY

FOURTH QUARTER 2007

FROM THE DESK OF J. WILLIAM WALTMAN, JR., CPA, CFP®

Fasten your seatbelts, turbulence ahead. U.S. equity investors experienced a rocky ride in 2007. The year started strong and then hit a major air pocket in July as the housing market continued to worsen, foreclosures rose, and the credit markets began to seize-up. Lending institutions across the

as 8.5%, effectively pricing themselves out of the market. Bear Stearns, an investment banking firm on Wall Street, announced that two of their hedge funds suffered losses on investments in subprime mortgage debt and would liquidate. Banks across the globe surprised investors with massive

(SIVs) sponsored by many Wall Street firms ran into trouble as the value of their securities plummeted. These SIVs posed a unique risk as they were off balance sheet. The risk that these assets could end up on the already stressed balance sheets spooked investors. In response, Treasury Secretary, Hank Paulson, proposed forming an industry-wide fund totaling \$100 billion to provide liquidity. This idea eventually failed and the banks brought these off-balance sheet investments onto the books. Significant losses cost Chuck Prince of Citigroup and Stanley O'Neal of Merrill Lynch their jobs. But don't shed any crocodile tears for them. Both walked away with millions in severance benefits. The losses at Merrill Lynch, UBS, and Citigroup became so large that all three sought and secured additional capital from sovereign wealth funds from the far-east to shore up their balance sheets. The Federal Reserve responded to

RECAP of 2007

globe became very cautious and reluctant to loan money for fear the funds would not be repaid. Thus the terms of loans became more stringent. The jumbo home loan market, loans in excess of \$417,000, was abandoned by certain lenders in July with other lenders charging interest rates as high

write-downs of collateralized debt obligations, mortgage backed securities, and significant increases to their provisions for loan losses. Citigroup, Merrill Lynch, and UBS, to name but a few, recorded write-downs on investment securities in the billions. In addition, structured investment vehicles

Continued on page 2

Stock & Bond Benchmark Indexes

INVESTMENT OBJECTIVE	Performance (%)			
	HIGH	LOW	2007	3-YR
Dow Jones	14,164.53	12,050.41	6.4	7.2
S&P 500	1,565.15	1,374.12	3.5	6.6
Russell 2000	855.77	735.07	-2.7	5.5
Lehman Bros. Agg. Bond	5.85	4.79	6.95	4.95

SOURCE – Wall Street Journal, January 2, 2008





Quarterly COMMENTARY

Quarterly
COMMENTARY
FOURTH QUARTER 2007

RECAP of 2007

Continued from page 1

the credit market crisis with interest rate cuts taking the federal funds rate down 1 percent to 4.25%. President Bush and

Treasury Secretary Paulson unveiled a modest program to provide relief to homeowners struggling with the interest rate resets on their variable rate home loans. As if all these headwinds were not enough, the price of oil rose from roughly \$60 a barrel in January to \$98 a barrel at the end of the year.

But not all the news was bad. Global growth continued to surge ahead led by the far-east economies. This coupled with the falling U.S. dollar led to a boom in exports which helped to offset the domestic slowdown.

Outlook for 2008

We expect the economy to continue to slow and flirt with recession in 2008. As the housing market remains weak and foreclosures, layoffs, and unemployment rise, the economy will come under further pressure. We do not subscribe to the thesis that there has been a decoupling of the U.S. and world economy. The thought that the rest of the world will continue to grow and thrive in spite of a slowdown in the U.S. seems illogical. Who consumes most of Chinese made goods? We do. If U.S. consumers slow their consumption of foreign-made goods, China will feel the impact. The countries that we export most of our goods to such as Canada,

Japan, Germany, France, and England appear to be slowing. Thus we expect to see worldwide growth slow this year. Look for further write-downs from bank and brokerage firms as the value of their securities are further impaired and loan losses tied to U.S. real estate increase. Analyst expectations for 2008 corporate profits remain too high in our opinion. For the first time in several years we saw corporate profits decline year-over-year in the third quarter of 2007. Look for this trend to continue. In this environment it will be very important to not place too much reliance on past "peak earnings" when assessing value. The Fed will most likely continue to cut rates in an effort to head-off a recession. In this presidential election year, expect to see politicians competing to offer more generous bailout proposals to beleaguered homeowners. Let's hope that any "solutions" coming out of Washington do not exacerbate the problem.

Opportunity KNOCKS

The market turmoil we are experiencing can be disheartening to even the most experienced investor. But times like these create "fat pitch" opportunities. In the coming months we expect to see great companies trading at very attractive values as fear increases. Patient investors with a 3-5 year time horizon may be well rewarded. As always we remain committed to helping you achieve your financial goals. Thank you for the trust you place in us.

J. William Waltman Jr.

2076 Lakeside Centre Way
Knoxville, TN 37922
www.pyawaltman.com
Phone: 865.693.6301
Fax: 865.693.6302

Registered Investment Advisor

Investment Management • Financial Planning • Retirement Plan Services