



# Brounes & Associates

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## AND THAT'S THE QUARTER THAT WAS... For the Quarter Ended September 30, 2007

### Market Matters...

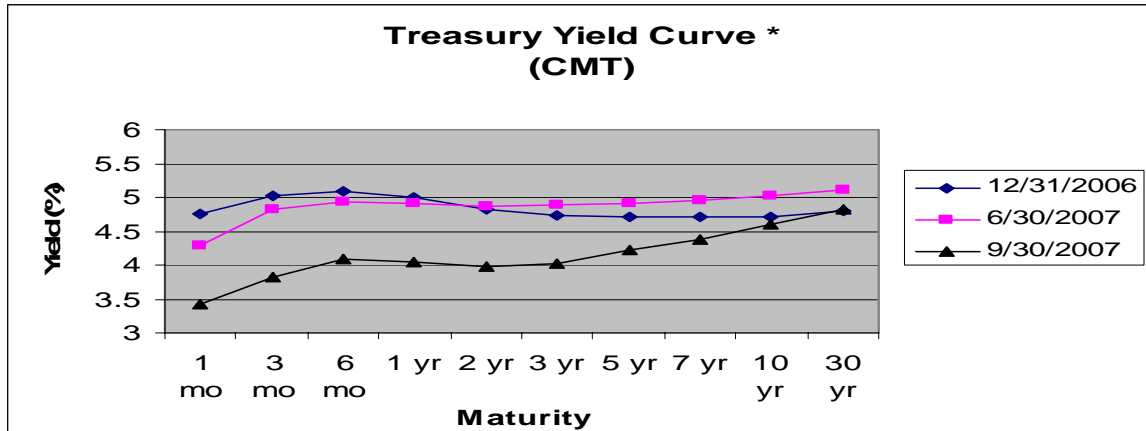
Market/Index	Year Close (2006)	1 <sup>st</sup> Qtr Close (03/31/07)	2 <sup>nd</sup> Qtr Close (06/30/07)	3 <sup>rd</sup> Qtr Close (09/30/07)	Qtr Change	YTD Change
Dow Jones Industrial	12,463.15	12,354.35	13,408.62	<b>13,895.63</b>	<b>3.63%</b>	<b>11.49%</b>
NASDAQ	2,415.29	2,421.64	2,603.23	<b>2,701.50</b>	<b>3.77%</b>	<b>11.85%</b>
S&P 500	1,418.30	1,420.86	1,503.35	<b>1,526.75</b>	<b>1.56%</b>	<b>7.65%</b>
Russell 2000	787.66	800.71	833.70	<b>805.45</b>	<b>-3.39%</b>	<b>2.26%</b>
Fed Funds	5.25%	5.25%	5.25%	<b>4.75%</b>	<b>-50 bps</b>	<b>-50 bps</b>
10 yr Treasury (Yield)	4.71%	4.65%	5.03%	<b>4.58%</b>	<b>-45 bps</b>	<b>-13 bps</b>

**OVERVIEW:** Is there a doctor in the house (actually a therapist will do)? This past quarter, the equity markets (and fixed income, for that matter) were not for the faint of heart. New records turned into major sell-offs which turned into slight corrections which turned into new records (or close). The daily volatility was enough to make anyone “fly over the cuckoo’s nest.” While many investors delight in checking their portfolios daily (if not, hourly), the Rip Van Winkle approach would have served them best last quarter: allocate according to goals and objectives, fall asleep for a few months, and review the results. Let the guy/gal in the next cubicle worry about the Dow busting through 14,000, the ever-growing subprime mess, the never-ending Fed-speak (including the ex-Chair’s book tour), the newfound recessionary fears, the “surprisingly” large fed funds cut (as well as the discount rate), and the favorable investor (over)-reaction. At the end of the day, they would have felt just fine about their portfolios and not suffered through the mid-quarter panic (unless, of course, they were overweight small-cap).

**SUBPRIME:** The quarter could not have come soon enough for Angelo Mozilo and Warren Spector. The respective heads of **Countrywide** and **Bear Stearns** (that is “ex-head” in Spector’s case) could barely make it through consecutive days without more negative news about their companies gracing the front pages of the business rags: from downgrades to layoffs; from liquidity needs to hedge fund woes; from **Bank of America’s** investment (bailout) to rumors about Warren Buffett. The guys had become among the most notorious poster children for the subprime debacle (though plenty of others at home and abroad have made that short list). While investors hope (and pray) that the end of this nightmare is drawing near, they should remain aware that about \$50 billion in adjustable rate mortgage loans are set to reprice to higher rates in October. As such, some borrowers will see their monthly payments increase significantly (despite the rate cuts) and the pace of delinquencies and defaults will undoubtedly rise.

**MARKETS:** The quarter started strong as just 57 days after topping the 13,000 level, the Dow Jones moved beyond 14,000, and investors basked in the glow of (seemingly) daily new records. Enter, **Bear Stearns**, **Countrywide**, **Goldman Sachs**, **Lehman**, **Northern Rock PLC** and many others. Suddenly triple-digit down days for the Dow became the norm and the major equity indexes each plunged by over 10% from the highs set in mid-July. Small-cap issues took it on the chin the hardest as those investors who were willing to commit to equities sought the perceived safety of the largest industry leaders. Mainly bonds benefited from a tremendous flight-to-quality move. The Fed’s symbolic discount rate cut eased fears as speculation ensued that Bernanke and friends would not let the situation spiral out of control (as if it hadn’t already). Prayers were further answered late in the quarter when Dr. B. surprised the markets by reducing funds by a greater than expected 50 bps. The Dow surged by 300 points that day and never looked back as and the others indexes (including foreign) followed suit. Only the small-cap Russell 2000 ended the quarter in negative territory. Thankfully, the doctor (Bernanke, that is) has spoken.

## Economically Speaking...



\* Reflects changes in interest rates over various time frames.

**HOUSING:** Though inflation had long remained public enemy number one, last quarter the Fed turned its primary focus to the housing sector which continued to get battered from the subprime fiasco. Early speeches seemed to indicate that most officials believed that the problem was well contained to just housing; but as the quarter moved forward, new data raised some growing concerns. In August, existing homes sales fell for the sixth straight month and new home sales dropped to its lowest level in over seven years. Further, those houses that did sell were going for bargain basement prices as the median sales price plunged by its largest percentage in 37 years.

**LABOR:** While manufacturing continued to grow at a slower pace, the labor sector suffered the greatest setback (outside of housing) during the quarter. In August, 4,000 non-farm jobs were actually lost from the economy, the first decline in four years. (And not everyone got as lucrative a package as Bear's Spector.) Though the jobless rate remains historically low at 4.6%, economists worry that newfound labor concerns could dampen the holiday shopping season.

**RETAIL:** On that note, among the biggest fears for investors amidst the mortgage negativity was the ultimate impact on the almighty consumer. After all, related activity contributes to 2/3 of the growth of the economy, so any disappearing act (no matter how temporary) could prove dire on future holiday sales and other sectors. In August, both **Home Depot** and **Wal-Mart** warned of slower earnings in the months to come, though many retailers (including the very same **Wal-Mart**, **Children's Place**, and **Saks**) reported strong sales activity. The jury is still out as the September consumer confidence index fell to its lowest level in almost two years.

**INFLATION:** In August, the wholesale price gauge (PPI) surprisingly fell by 1.4%, its largest monthly decline in 10 months. Likewise, consumer prices (CPI) dropped for the first time in those same 10 months, and the core (excluding food and energy) data showed that retail inflation remained well contained. However, before economists proclaim an outright end to any pending inflationary concerns, beware that oil prices have climbed beyond \$80/barrel and those prices have yet to be felt throughout the PPI and CPI releases. Looking ahead, the weak currency could also contribute to future price woes as goods and services abroad are growing more and more pricy with the dollar falling to record lows against the euro.

**GENERAL:** While the economy advanced by 3.8% in the second quarter, many naysayers are predicting that the GDP only climbed by about 2.5% from July through September. Surely, a rate cut is just what the doctor ordered and the fourth quarter will once again be back on track. Then again, lots of unanswered questions remain (and don't call me Shirley).

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