Campbell Capital Management

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Dear Money Management Client:

You wouldn't know it's been a tough year in the stock market by looking at your enclosed performance statement. We've been fighting the market averages which are negative on the year, interest rates that are moving higher, oil prices moving much higher and two monster hurricanes. Corporate America remains productive and profitable, but investors lack the confidence to bid prices up. Investors know that if the Federal Reserve's concerns about inflation and housing speculation cause the Fed to keep raising short term interest rates, the economy will slow and corporate earnings will fall.

Not wishing to "fight the Fed", we've grown more cautious as the credit tightening cycle continued. The Federal Reserve has warned us in each monthly open market committee meeting that monetary policy is too accomodative and therefore rates are headed higher. It's true that most of the inflation concerns are due to higher commodity costs, but the Fed assumes their "easy money" policies over the past few years are the real culprit. And if you look at the increased demand for raw materials, you realize all the emerging markets are building infrastructure and manufacturing goods just to keep up with the insatiable demand from the United States.

During the past year, the United States increased its debt to the rest of the world by $600 billion dollars. Which means consumers in the U.S. purchased a lot more goods from foreigners than they sold to them, and that's why the United States is such an important part of the world economy. If the U.S. were to sneeze, the rest of the world would catch a cold.

Obviously, the United States can't forever consume goods at a feverish pace and expect the rest of the world to loan us the money, but for how much longer is the subject of great debate. Right now export economies have no choice but to sell us the goods and loan us the money. But if there ever comes a time when foreigners are concerned with our ability to re-pay the debt, it's liable to get ugly in a hurry. And for that reason export oriented economies must learn to trade with each other and develop demand from within.

International markets and natural resource plays have been doing well and account for most of our success this year. If the U.S. economy slows, we would expect the leash effect to take some wind out of the emerging market and commodity sails. The dollar is benefiting from higher relative short term interest rates, but longer term it's headed lower, and the best analogy is "bankers never lend money to someone who really needs it".

We remain committed to a conservative investment philosophy, which emphasizes the preservation of capital. If you have any questions or would like to discuss your portfolio, please do not hesitate to call.

Very truly yours,

Clay Campbell