Campbell Capital Management

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Dear Money Management Client:

The news flow is just awful. The financial news is a horror show and unfortunately things are getting worse. More crooks are being exposed, more banks are insolvent, more people are unemployed and more municipalities need money…. it's a steady stream of ugly. Will it ever end? Of course it will end, but not soon enough for any of our liking.

The recession officially began over one year ago and will likely last another year. Our economic downturn was set in motion when the housing bubble burst, and a meaningful recovery won't occur until housing prices stabilize. Home prices have fallen approximately 25% and will likely fall another 10% before we make any progress working off what is an unprecedented excess supply of homes. Lower mortgage rates and government aid will help, but it all takes time.

Personal consumption is contracting sharply because of the negative wealth effects of housing and equity market losses. It's a recession, and the normal course is for people to spend less and save more while they repair their balance sheets. A negative feedback loop is created where less spending results in more layoffs and more layoffs result in additional mortgages going delinquent. Government loans, guarantees and spending are the prescribed medicine, and the prescriptions are being written abundantly. But again, it takes time.

The overwhelming economic issue involves what we call the "debt super cycle". Americans have lived beyond their means for years by assuming ever greater debt balances; car leases, credit cards, first mortgages, second mortgages, etc. Gross domestic product is mostly consumption and since consumption was fueled by home mortgage equity withdrawals the past few years we are now in for a period of lower growth. The debt super cycle is over and we must learn to spend what we have, not what we can borrow.

The next few years are going to be about healing. The credit crunch and deleveraging will run their course, inventories will be depleted, excess capacity will be removed and world economies will grow leaner and stronger. We expect this to be another difficult year for equity investors. It is likely economic growth will be low and below trend for a number of years. In spite of this, we are very optimistic about the growing opportunities for investment. In the fourth quarter we purchased numerous high yielding, high grade corporate bonds, which are expected to provide stability and a generous income stream over the next two years. We also added several closed end bond and preferred stock funds selling at steep discounts with high payouts. Our few equity purchases were limited to infrastructure themes where we believe the new administration's spending will be directed.

As the year progresses, analysts' corporate earnings estimates will continue to be lowered until we reach a sweet spot where reduced expectations birth a new cycle of earnings outperformance. When that time comes, we look forward to doing what we do best; finding great companies with great balance sheets and expanding opportunities at attractive valuations.

On the subject of inflation, loose labor markets and weak demand for commodities and goods/services will keep producers' prices down this year. But investors are concerned that the Federal Reserve policy of "quantitative easing" will result in a big inflationary problem down the road. Their fear that abundant liquidity will lead to inflation only holds true if the Fed doesn't remove the liquidity as economic recovery occurs. History is on the inflation argument side, but it doesn't have to be so. Nobody knows how the inflation story will end because nobody knows how the Fed will act. All we can do is wait and watch, each week as the Fed posts its balance sheet for our eager review.

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

Very truly yours,

Clay Campbell

SEC Disclosure

As you know, Campbell Capital Management is registered as an investment adviser under the Investment Advisors Act of 1940. We are required to update the information in our Form ADV periodically, to ensure that it contains up-to-date information about our company. If you would like to receive a free copy of our most recent amendment to Part II of our Form ADV, please call or write us at the address below.

Please send your request to:

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