

MARKET POINT



AN ASTUTE OBSERVER ONCE COMPARED the art of investing to an ocean. To paraphrase, he opined that the vast majority of investors spend the vast majority of their time focusing on the ripples, when and where they will occur. A few of the more savvy investors spend their time on the waves, their direction, magnitude and speed. However, he went on, knowing when the **tides** will come in and go out is what makes fortunes.

As the world gets smaller as a result of free trade and technological advancement, there has been a huge improvement in the living standards of hundreds of millions of people around the globe. The liberalization of formerly planned or closed economies has provided their citizens access to capital like never before and the technical capability to leverage knowledge and encourage entrepreneurialism—the fuel of innovation.

With an advancing global economy and developing nations moving from abject poverty to poverty to middle class, the voracious appetite for raw materials that we have mentioned before continues. While demand growth fluctuates greatly, it will be a significant positive average number going forward. The consequence of this is the intense competition for the basics such as steel, copper, and oil, as nations keep bidding up prices to secure their share. Moreover, resources are now scarce as a result of two decades of under funding new capacity, and unfortunately, geopolitical turmoil is one of the results.

Resource Nationalism is the new buzzword.

This dynamic, which likely won't end soon, has led us to a point where metal and energy reserves in politically secure areas are increasing in value at a prodigious rate—this despite the fact that the stock prices of the owners of such reserves have meandered sideways for most of 2006 [mostly due to a withdrawal of liquidity/credit by previously stimulative central banks and disinvestment by short-term oriented hedge funds]. These investments have been the standout stars for the last four years and we expect this to continue given their robust financial profile and worldwide business prospects—of course with periodic setbacks.

Surging global demand for raw materials is a **tide** that investors need to pay attention to and be positioned to benefit from. However, it is imperative to manage the risk of the underlying investments and ignore the schizophrenic nature of market participants as there will likely be volatility as the global economy slows, and as the mainstream media continues to debate whether or not we are experiencing a “commodity bubble” (which we firmly believe is not the case).

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bermeyer

ASSET MANAGEMENT COMPANY

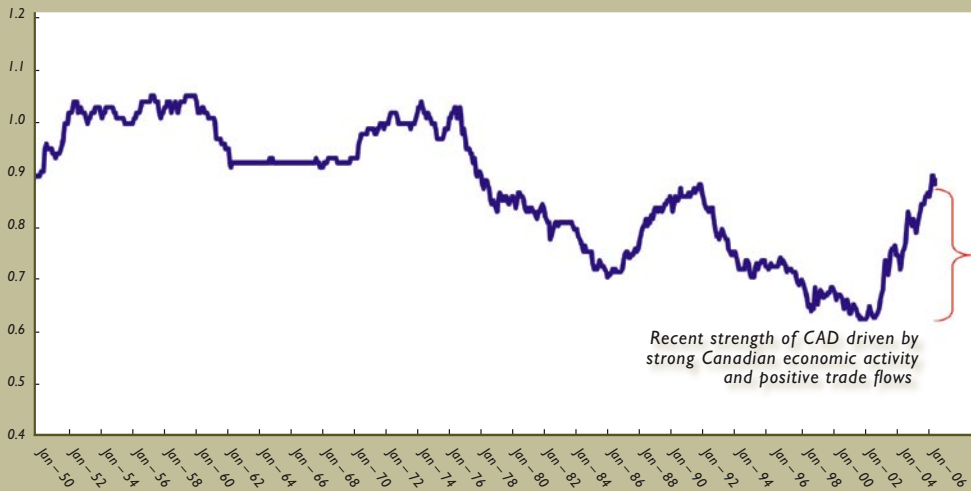
“

...Canada holds the assets the world needs—whether it be petroleum, gold or timber—and it operates its government and its trade account on a surplus...”

While investing in mining and energy reserves in politically secure areas is a bold and likely lucrative endeavor, doing so for a US-based investor in a potentially overvalued currency presents more of a challenge. **This brings us to Canada.**

Canada may be a country known for its strong winds and harsh climate, but it is also politically secure and rich in natural resources. The chart on the left shows the conversion rate of one Canadian Dollar (“CAD”) into one US Dollar (“USD”). As depicted, holders of CAD denominated assets received a 50% markup on their portfolio over the last several years from currency gains alone versus USD assets. This was no accident and is not because of speculation; furthermore, we expect this dynamic to continue. This is because Canada holds the assets that the world needs —whether it be petroleum, gold or timber—and it operates its government and its trade account on a surplus (the opposite of its neighbor directly south).

CAD/USD Exchange Rate



Source: Freelunch.com

As you are aware, the US is extremely levered, borrowing on average \$2 billion dollars a day to keep consumption and asset prices high. As such, there is risk to USD based assets if foreign lenders diversify their loans and stop purchasing our Treasury and mortgage-backed securities. Such a scenario will likely less affect Canada because emerging countries will continue to need what Canada has as their economies become self-sustaining.

While the US is still an attractive place for foreign investors to put money because it has the most advanced capital market systems, top quality universities, solid private property laws, etc., it makes sense for clients to mitigate some risk by holding some Canadian investments, with a focus on those with high-quality, long-lived assets. Our portfolios have Canadian positions through investments in select Canadian stocks and CAD denominated bonds. The next downturn has the potential to make the US look poor compared to the rest of the world, and if this bears out, Canadian investments should outperform.

Obermeyer Asset Management firmly believes the most important objective for any investor should be to increase their share of global wealth. Beating the S&P is an arbitrary and antiquated goal in today's world and, even if successful, may end up getting you nowhere—especially if the US dollar declines. ■



TOP OF MIND

“STOCKS WILL FLUCTUATE”

WHEN ASKED ABOUT THE FUTURE OF THE MARKETS,

legendary financier J.P. Morgan (1837-1913) retorted: “Stocks will fluctuate.” This quote is as applicable now as it was then, and will be equally universal during all of our investment lifetimes.

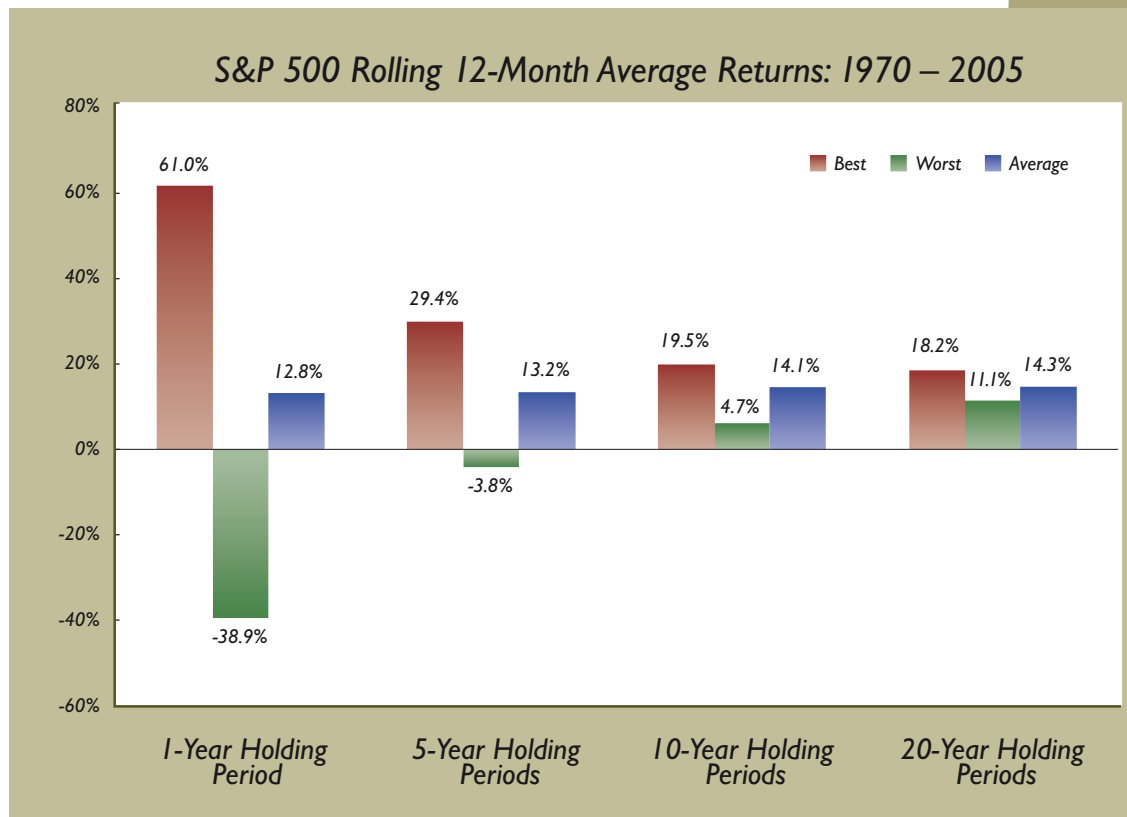
Even though we all know that stock prices will be volatile, we recognize it is difficult to stomach down periods in the market. These periods test all investors regardless of their age and experience, yet it is the ability to remain steady and to remain invested that will likely get one’s fortune further over the long haul. **This is because no one can predict in the short-term when prices will go up and when prices will drop.** The key

instead is to invest your portfolio in the securities of companies that are trading at attractive prices and whose businesses have a high probability of making money because they are poised to generate solid cash flow, their management teams are on the ball, and their products/services are desired and value-added. This strategy stacks the odds in your favor for generating attractive real returns over time—even if your account balances fluctuate and decline periodically as they are guaranteed to do.

As depicted in the graph on the right, the general US market (as measured by the S&P 500) has experienced extreme highs and lows when viewed on a short, 1-year time horizon. However, if you consider lengthier time periods, stocks have generally posted positive returns. While past performance does not guarantee future results, a historical perspective reminds us that the market has endured tough periods in the past and that over 5, 10 or more years, down markets have minimal impact on your average return.

It is also important to be aware that during times of geopolitical conflict, the markets generally sell at a discount to times of peace. This is appropriate because conflicts disrupt trade patterns, reduce productivity due to security concerns, create uncertainty, and increase business risk. As such, we may experience a lower return environment on average during this market cycle as compared to the 1990s.

People sometimes naively assume that difficult markets equate to a poor investment climate and that the answer is to sell stocks and seek safety in cash. **We strongly disagree with this.**



For long-term investors, there are always opportunities, and it is our job to find them. It is important to tune-out the scare mongering media that proclaims the sky is falling, and instead focus on what trends will likely shape the global economy going forward and determine how to make investments in a prudent, thoughtful manner. Since “stocks will fluctuate,” lower prices can create opportunity. ■



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(Pictured above, from left to right)

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BUSINESSWEEK MAGAZINE APPROACHED US earlier this summer and asked us to contribute to its Annual Retirement Issue. This topic is near and dear to many of our clients—as well as the public at large—so we were honored to pass on a few pointers to their readership. The piece was a two part segment—a short blurb in the magazine and then a more lengthy version on their marketing partners' website. Below is a summary of the article which we titled "How to Bullet Proof Your Financial Future." The longer web version is available at www.finance-insights.com/obermeyer.asp.



"A good way to secure your financial future is to compound a lot of money for a long period of time at high rates of return. While daunting, this can be done..."

1. Start early and be realistic...

2. Focus on purchasing power—not principal. A common mistake people make is fixating on "principal and income" and in doing so, invest too conservatively. Inflation and taxes can easily wipe out the majority of certain investment returns. To keep pace, you need to position your portfolio to grow by investing a

portion in longer-term assets such as equities. This should enable you to maintain your standard of living.

3. Stick with solid investments that are attractively priced and resist the temptation to sell during down markets. Mentally prepare yourself for difficult markets by knowing they will come and that you will survive...

4. Modify your strategy as your lifestyle evolves and as opportunities emerge.

In general, your portfolio should be positioned to maximize growth when you are adding to it, and its asset allocation altered once you begin taking income. Likewise, be aware that the best investment opportunities may exist in the US market for a decade, but as valuations change, better risk/return prospects may surface elsewhere. It is critical to tailor your strategy to suit your personal situation, and to adjust your portfolio from time to time to position correctly for attractive long-term opportunities." ■

Summarized from the *Annual Retirement Issue* of *BusinessWeek*

Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be suitable for an existing or prospective client's investment portfolio. Therefore, no existing or prospective client should assume that future performance of any specific investment or investment strategy (including the investments or investment strategies recommended herein) will be profitable or equal any historical performance levels.

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