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We feel like pulling in our horns with respect to risk exposure, back to normal that is. For some time we were comfortable with an extra bias to stocks along with a bond strategy that was low risk both as to maturity and issuer. This posture allowed the rise in stock prices, uncertain though it has been through year end, to have had a positive effect on returns while we watched (from the comfort of an oasis of Treasury bonds) the credit markets undergo a convulsion. Reason for our pullback in positivity is the unusual convergence of too many big things changing simultaneously, and a fair chance that one or more could go badly in four areas: politics, the economy, junk mortgages and the war.

For fear of impugning somebody's favorite candidate we will limit our observation by noting only that we have never seen so wide a diversity of viewpoints on both sides, found it so easy to pick the best one, and still not be able to predict the winner. The short version is that while the Democrats are less well positioned than six months ago owing to a change in tide on the Iraqi front, they are still quite strong, and this bears upon the probable future direction of taxation, government spending patterns and the makeup of the Supreme Court. It computes as an increase in investment risk.

The stimulation emanating from world expansion is responsible for the positive effects on the well being of the world but every twenty years or so, the incautious are sold a new way to make money by people who should know better.

The bubble we have been going through is a mix of real estate and irresponsibility. As it plays out it depresses demand, and our mood, as we pick through the damage done to investors and financial institutions. No one will be surprised if a recession ensues but the world economy is pumping along pretty well even with the surge in the price of oil and other important commodities. Gut feel says we're in for a slowing of the growth rate instead.

A greater concern is that of inflation, one of the stresses to be expected while we undergo rapid growth funded by a lot of debt. Central bankers have learned that in time of financial stress, the generous provision of credit is more palatable than letting the chips fall as they may.

The junk mortgage upset will be overridden by the same tool. An enforcing factor is the convergence of rising cash flows to engorged oil states, a decline of the dollar in world markets, the growth of China, and an evolving realignment of economic heft among the large powers. These circumstances elevate the importance of inflation protection.

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With respect to the war, as the agenda of Jihadist decision makers becomes more widely understood, the subject will become less politically charged. The new president will have to deal with the reality of having to fight or be embarrassed by losses. The conflict may be part of the world scene for a long time to come and should become a more widely shared burden. If the American role is limited to training, equipping and assisting in occasional combat on a smaller scale while secular Muslims gradually gain power, the burden should be bearable. There is room here for surprise either way.

That blend is what we have to work with in 2008.

Best Wishes

John May