

# alpha+ capital management

*April 9, 2008*

Dear clients,

Threat of seizure in the investment markets eased palpably in mid March when a financial brigade of key players in the Treasury, Fed, Administration and Congress got their arms around the problem in a two step process: First, by understanding how a high magnitude of leverage was applied in the game of borrowing short while lending long, in this instance worsened by irresponsible lending to irresponsible borrowers who would repay debts only if things broke their way. Second, by establishing a triage policy for financial institutions designed to identify and stabilize the big bleeders. Also helpful was a subdued level of political posing over the opportunity to gather votes at the expense of principles like integrity of contract and ownership of losses as well as profits.

We moved away from credit quality risk in the Fall of 2006, when the build-up of risk in the credit markets became apparent. We bought US Treasuries and Inflation Protection bonds. In the recent concern over quality, illiquidity and inflation, large flows of money moved into Treasuries, pushing prices higher. Now we think it is time to reach out for higher return by moving about a third of the position in Treasuries back to investment grade short term corporates. If conditions continue to improve, we will do more of the same.

Stock positions are being held at normal because the business outlook over the next three years and the longer term comfortably justifies current prices. Current stock prices coexist with four negative dynamics: domestic politics, the War, the credit convulsion and the economy. Each of the four exerts a negative influence on stock prices. Should any turn favorable or become less unfavorable, stocks would be buoyant.

Long story short,

- 1) Political forces have moved closer to even, in an intensely interesting political drama.
- 2) The War recently became less of a depressant as the Iraqi Army began to be seen as capable and growing stronger. Major remaining belligerents are in the Sadr group supported by Iran. If the Iraqi government continues to develop and violence quiets, the effect would be strongly positive.
- 3) The credit upset is being calmed. We are blessed with a crew of smart, cooperative money people able to make timely and logical decisions. No big mistakes so far, and they seem to prefer erring on the side of generosity. Positive.

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- 4) If a recession occurs this year, it would be one of the more highly predicted in economic history, and probably run-of-the-mill in intensity as the decline in housing related business will be partially offset by growth elsewhere including cheap US exports in an expanding world economy. Absence of a recession would be seen by the market as a positive surprise.

One other thought: all these inflatables (real estate, gold, oil and industrial commodities) are at or near historic highs. Stocks are the lone exception.

Best wishes,

John May