SANSOTERRA GROUP LLC

THE DOG DAYS OF SUMMER

Our puppy is now a year old. He has bouts of wild enthusiasm followed by very long naps on the best furniture. The ritual, I'm sure, will persist well into middle age. Dog owners understand the behavior – everything is new, exciting and worthy of a good chew, but to keep it going requires long naps if not periods of good behavior.

I am seeing the same characteristics in the stock market. After a number of years of steady behavior coming off the crash early in the century, the stock market has taken on puppy-like moves.

Some might argue that the analogy is <u>too</u> good – that this is an out-of-control market and the sizeable swings of late portend future instability if not worse.

I am not of that belief. It seems to me that the larger picture is still one that reflects three significant factors:

- global economic expansion resulting from global information flow, the gradual collapse of trade barriers and the emergence of millions of new consumers world wide;

- significant amounts of liquidity, globally provided not just by central banks, as was long the case, but also by private investors, oil wealth, venture pools and new stock and bond markets, i.e. China, India;

- a disproportionate distribution of the profits flowing from this global expansion with the majority coming to the United States and the companies that anticipated this growth.

The problem with this good news is that most investors know it and few investors appreciate how tenuous (perhaps a better word is evolutionary) it all is. These are major history-making shifts toward increased standards of living world wide - - - and that road cannot be a smooth one. We need to look no further than our own post-war cycles of boom, recession and re-growth. We swung, regularly, from economy-wide recession to periods of remarkable growth. The growth in our economy has smoothed considerably in the last 10 years or so reflecting, I believe, both the three items noted and also the transition of our economy away from a union-dominated manufacturing economy to one dominated by services, technology improvements (cost of a phone, TV, etc.) and access to global producers of the goods we want.

And therein lies the rub. We may have exported our volatile manufacturing sector, but it will now impact the countries that took it on (China, India, parts of Europe) and <u>tha</u>t will impact overall global economic growth.

Jack Welch points to levered buyouts and the like as making us more competitive – and I hope so. We are being banged hard by countries with lower labor costs (for now - that happened here, too, and it changed). The edge we need is stimulated by buyouts, layoffs and mergers.

So the mid-cycle slowdown continues – caused by a cast of characters that include a slumped housing market, rising food and fuel costs hitting all of us with wage gains smaller than price increases, and continued outsourcing. (It amazes me how low unemployment is in spite of all we read about lost jobs . . .)

WWW.SANSGROUPLLC.COM
4900 WILLIAMS ROAD • SAN JOSE, CA 95129
408 253 3568 • FAX 408 253 3568

Let's note, however, that the "developing" economies are seeing accelerating economic growth, which is why we invest outside the U. S. But it remains a slowing – a marginal pause, with a still real possibility of accelerating growth. If it weakens any further I expect a rate cut before Christmas.

As I see it, then, we still have the backdrop for solid global economic growth. I could build a case, I think, that it is spreading and my evidence would include the proclivity of most countries to cut corporate tax rates – except us, of course. Everyday, more and more people world wide grow more aware of the wealth in places other than their own. Sometimes violence ensues, as in the Middle East; sometimes brilliant economic decisions are made, as in Ireland where a 12% or so corporate tax rate is being proposed. At the center are the investors. Some see the long view and accept the periodic panicky moments; some see only pending disaster from "too much debt" (we are headed toward record low budget deficits) and some trade the volatility, exacerbating it in the process (hedge funds, day traders, amateur money managers). It is my view that it remains

- impossible to "time" the markets so you wait for entry points and, once on board, go on with your life;
- important to have a sense of the general direction of all economies, not just our own, and why;
- hard to compare things like price to earnings ratios of today's "growth" stocks – stocks growing 10% to 20% annually - with the metrics of the 50s and 60s when "growth" meant 10%;
- critical to be invested outside the U. S. in spite of the fact that many U. S. firms have foreign ventures;
- important to know that your crazy uncle, your barber and the guys you work with are all expert investors, happy to tell you how well they are doing; and know less than you do;
- important to diversify.

I am not oblivious to terrorism, rising gas prices, food prices, medical services and the like. What I think is forgotten is that for the majority of American families, these items constitute a shrinking part of their budget. Cold, you say? Then explain the confluence of falling consumer debt payments as a percentage of income and rising consumption of $5,000 televisions and $400 shoes. May I remind you yet again that the media sells sob stories, disasters, violence and sex; that while the middle and upper classes of income dominate consumption, the disenfranchised dominate the evening news? I know gas prices hurt the working poor – it's not a question of lack of empathy, it's a question of what influences what.

July 2007

This material is for your personal use and is neither an offer to sell or buy securities nor is it a solicitation of your business. It should not be redistributed in any manner without approval. We believe our sources to be reliable, but cannot warrant the information herein as complete or accurate – and it should not be treated or relied upon as such. An ADV Part II is available upon request.

WWW.SANSGROUPLLC.COM
4900 WILLIAMS ROAD • SAN JOSE, CA 95129
408 253 3568 • FAX 408 253 3568