



FAI Advisors, Inc.

Monthly Investment Commentary

JULY 2008

The first half of 2008 dramatically reinforced the idea that over the short term the stock market is predictably unpredictable.

A sharply negative first quarter was followed by two months of positive returns, but the selloff resumed with a vengeance in June, with large-cap stocks (as measured by Vanguard's 500 Index Fund) dropping 8.4% for the month and almost 3% in the second quarter. The S&P is now down 12% for the first half of this year, and is about 18% below its October 2007 high. The market offered few places to hide, the only exception being the commodities areas which are still driven mostly by rising oil prices.

Updated Market Data

"A Year in Review"*

	June	YTD		6/27/08	6/27/07	% Chg
Large Cap Benchmarks			Consumer Rates			
Vanguard SP 500	-8.40%	-12.00%	1 Year CD Yld	3.03%	5.02%	-39.64%
Russell 1000 Growth ishares	-7.20%	-9.10%	30 Yr Mortgage	6.45%	6.67%	-3.30%
Russell 1000 Value ishares	-9.60%	-13.60%	Prime Rate	5.00%	8.25%	-39.39%
Nasdaq (QQQQ)	-9.68%	-11.78%	Commodities			
Dow Jones Indust (DIA)	-10.08%	-13.61%	Crude Oil	131.41	68.29	92.43%
Small Cap Benchmarks			Gasoline	4.10	3.03	35.10%
Russell 2000 Growth ishares	-6.00%	-0.89%	Gold	923.00	643.00	43.55%
Russell 2000 Value ishares	-9.60%	-9.80%				
Other Benchmarks						
Vanguard REIT Index	-10.80%	-3.40%				
Vanguard Total Intnl Stock Idx	-9.00%	-10.90%				
Vanguard Total Bond Idx	0.00%	1.10%				
Merrill Lynch High Yld bond Idx	-2.70%	-1.20%				
Citigroup World Govt Bond Idx	0.40%	5.00%				
DJ-AIGCI (Commodity Futures)	9.10%	27.20%				

* Source: JP Morgan Weekly market recap

What is Driving Stocks Lower Again?

As always happens in an environment of fear, we are being asked (and asking ourselves) a lot of questions. What is going on, and how bad could it get? Is there anything we should be doing about it in our portfolios? One thing that is common to all historical periods like this is that a sense of accelerating bad news, escalating risk, fear, and panic were almost always present. With the bailouts of Bear Stearns, Fannie Mae/Freddie Mac, high fuel prices, the housing market price declines, and new waves of foreclosures hitting the market, it seems there is no immediate end in sight.

Due to all this endless negative data, consumer confidence is at a 28-year low; the last time it was this low inflation was 14% and unemployment was over 7%. With actual inflation and unemployment much lower, it seems there may be a perception problem. Consumers can change their actions (spending) based on how they “perceive” things to be, not necessarily how things are for them individually. For those of us that live in the Detroit area, we know this happens. This can be problematic.

“Nothing in life is to be feared. It is only to be understood.”
—Marie Currie

As always, there are positives as well. Outside the financial sector, corporate balance sheets remain generally healthy and earnings have been okay. One source of strength has been exports, which so far have managed to offset much of the impact of the housing

decline on our economy. But this could diminish if our slowing economy means we also export economic weakness to the rest of the globe, and there are signs that this is happening.

Though we have experienced a multitude of market crises, we also recognize that history never repeats itself exactly, so almost anything can happen from here. In this type of environment, a sense of perspective and a reliance on our investment discipline helps us avoid becoming panicked by short-term concerns and paralyzed by longer-term uncertainty. Like it or not, we are always faced with making decisions in an uncertain world and this will not change. However, our experience in past market cycles and our analysis of the current market environment leads us to two important conclusions.

First, we do not believe it is time to get more defensive and reduce our equity exposure. It is easy to put too much weight on the negative when bad news dominates the headlines, but we view stocks as priced to outperform bonds over most five-year scenarios.

Second, big market downturns invariably present opportunities, and without them, we would not have the chance to identify the opportunities that can add value to our portfolios. Bubbles lead investors to make errors in judgment and misprice assets on the way up. On the way down, riskier assets often fall to bargain prices when investors are in the grip of fear. Our investment discipline can help us identify those asset classes where investor panic has led to excessive undervaluation.

FAI Advisors, Inc.
Investment Policy Committee (7/14/08)

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