

# T H E A D V I S O R



Bill



Mark



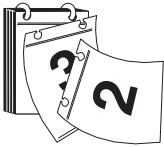
Joe

THE **ADVISORS**  **GROUP** Registered Investment Advisor  
 HELPING YOU PLAN FOR WHAT YOU VALUE MOST  
 Securities offered through LPL Financial  
 Member FINRA/SIPC

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## YTD Performance 6/30/2008



Dow Jones Inds.	-13.38
NASDAQ	-13.55
S&P 500	-11.91
Russell 2000	-9.37



### Fixed Income Indices

Lehman Aggregate	+1.13
Lehman Govt Long	+1.42

### Int'l Stock Indices

MSCI EAFE	-10.58
MSCI Emerg. Mkts.	-11.64

## The Oil Bubble

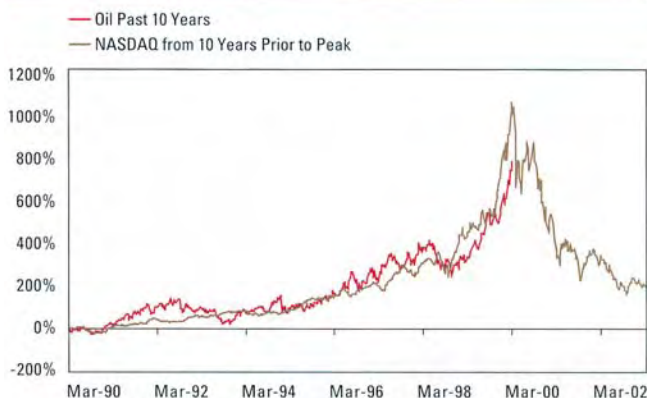
We recently noted that the powerful stock market rebound from the low of mid-March was now likely to give way to a volatile, but range-bound summer leading up to the election. Recent performance likely marks the start of this summer of volatility, which is typical of presidential election years. The big contributor to the stock market pullback towards the end of May was the surge in oil prices.

Oil prices are in bubble territory. The parabolic move in oil prices echoes that of the NASDAQ bubble that peaked in March of 2000. The price of oil has risen 50% in the past four months and more than doubled in the past year. This has happened even as inventories of crude oil have been

building to well above average levels, demand has declined among developed nations, and slowed among emerging market countries like China. On May 23, the Department of Transportation reported that Americans drove 11 billion fewer miles in March than they did a year earlier - the 4.3% decline is the first year-on-year decline since the 1979 oil shock and the sharpest decline ever. The conundrum of higher prices despite weakening demand and abundant supply can be explained by recognizing that while the physical commodity remains in balance with regard to supply and demand - the financial commodity of oil is clearly out of balance with far more investment demand for commodities than supply. During the buildup of the NASDAQ bubble those later called speculators considered themselves, at the time, to be long-term investors. Today, with all the talk of speculation in the commodity markets, the buyers of commodities also consider themselves to be long-term investors in the commodity markets. Many investors have been increasing their portfolio allocation to commodities.

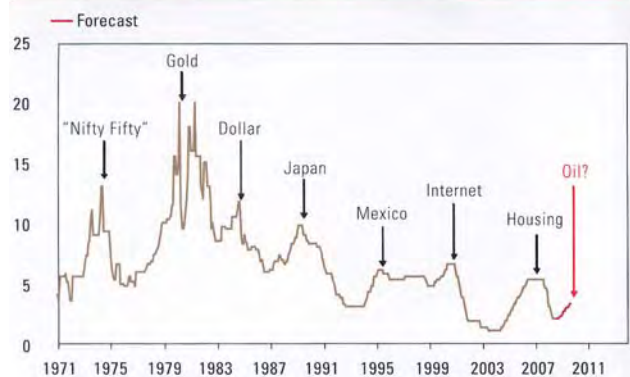
When an investor, like the California Public Employees' Retirement System (CalPERS) for example, increases their commodities allocation from \$450 million to \$7.2 billion (they announced this shift in February of this year with

Bubble Territory - NASDAQ and Oil Prices



Source: LPL Financial Research, Bloomberg

Fed Rate Hikes Have Ended Past Asset Bubbles  
 Federal Funds Target Rate and Peak of Past Asset Bubbles Labeled



Source: LPL Financial Research, Bloomberg

the intention of implementing this 16-fold increase in their allocation to commodities by 2010) it goes to commodity futures contracts rather than actual physical commodities. Of the volume of trading in commodities future markets, 80% is in energy contracts. Commodity indexes like, the Goldman Sachs Commodity Index (GSCI), are volume weighted - since volume is a measure of liquidity. The billions of dollars flowing into commodities are going into just a handful of futures contracts (dominated by the crude oil contract). As a result, the supply and demand for the financial investment in commodities is out of balance - billions of demand but relatively few futures contracts to be bought - pushing the price into bubble territory and a decoupling from the fundamentals of physical commodity.

The rise in the price of oil has weakened demand for the physical commodity, but it has boosted demand for the financial commodity since more investors are chasing the returns. The soaring demand measured by the volume of net long positions in the commodity futures contracts clearly suggests a level of financial demand for commodities that is many times what we have ever seen before and indicative of a financial bubble in commodities, especially crude oil.

When will the bubble pop? Financial bubbles typically require policy actions to end them. Both the Federal Reserve (the Fed) and Washington may take aim at commodity prices.

Washington has taken some efforts to slow the rise in oil.

- Democrats have recently proposed the "Consumer First Energy Act" which contains provisions to limit speculation in the futures markets by raising margin requirements along with a windfall profits tax and the repeal tax incentives for energy companies.
- Additions to the Strategic Petroleum Reserve have been halted.
- Senator Joe Lieberman has proposed changing the rules that exempt index funds from position limits.
- Republicans are proposing opening new areas for drilling and mandating coal-to-liquid processes. However, most of these efforts are unlikely to become law and only those focused on the commodities futures market are likely to have any near-term impact on oil prices.

Past bubbles have required rate hikes by the Fed to end them. Looking back at the past 40 years of asset bubbles

we can see that about every five years a bubble develops and bursts.

Typically, the Fed lowers rates to limit the economic damage in the aftermath of the bursting of a bubble, these low interest rates then sow the seeds of the next bubble. The bubbles burst as the Fed hikes the fed funds rate. The Fed is expected to begin to hike rates later this year. Until then it is possible oil continues to climb and weigh on stocks contributing to the volatile, range-bound performance likely in the coming months.

## LPL Financial Statements

The LPL Financial Statements are being redesigned. The fresh, clean look will make it easier to understand your financial "big picture" at a glance. Enhanced tables will show how your investments have performed during the statement period, and where you stand. Lastly, the information flows from summary to underlying details to allow for simple navigation. The new layout will be implemented starting July 1, 2008, to better allow you to easily obtain the information you need.

## Go Green

If you are an Account View subscriber you have the option to turn off your paper monthly statements and view them online. To do this simply click on the blue box labeled "Go Paperless" and follow the directions. Remember you can always go back to receiving paper statements at anytime. Tax statements will always be sent via regular mail.

## Just a Reminder

Every Monday morning from about 8:00 a.m.–9:30 a.m. our office has a staff meeting. Unfortunately, we will be unable to answer any phone calls during this time frame but will promptly return all messages. We recognize the inconvenience this may cause but we believe this time is necessary to continue to provide the level of service you have come to expect.

*The Nasdaq Composite Index measures all Nasdaq domestic and non-U.S. based common stocks listed on the The Nasdaq Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.*