



MANCHESTER

CAPITAL MANAGEMENT, LLC

In this Issue:

- ◆ Market Outlook
- ◆ Investment Opportunities Abound?
- ◆ Inside MCM

What's Next?

By Ted Cronin, CIO

The history of the stock market records that about every five years, such as in 1987, 1994, 1998, and 2001, the stock market declines about 20%. The stock market as measured by the S&P 500 was up 105% from its prior low in October of 2002. It is now down about 17% since last November. By the numbers, this looks like a standard correction that should be close to the bottom.

However, the current correction has more turmoil and panic than normal. The housing market bubble is still in the process of deflating, and has triggered one of the most severe credit crises we have ever experienced. We are in uncharted waters. For the past several years, banks have been loaning money to borrowers with little regard for the value of the collateral or capacity of the borrower to repay. Now, as more and more borrowers are unable to repay, we have a severe credit contraction where banks are reluctant to do anything. They are scared to lend, they are being forced to admit their mistakes and write off billions of bad debt, and they are not sure what they own or what they owe. The credit markets are frozen like a deer in the headlights.

The credit crisis is slowing economic growth in the US and around the globe. The earnings recession we identified last quarter could turn into an economic recession. At best, we will escape with a flat GDP, rather than negative growth in the economy. Unemployment has risen to 5.1%. Inflation is increasing to over 4.3%. Energy and grain commodities are reaching bubble levels, with wheat, for example, soaring to prices unimaginable six months ago. The dollar is declining in relationship to most currencies, as the Federal Reserve cuts rates and our trade deficit balloons.

As we try to understand what happens next, I believe it is a matter of when not what. The markets will rebound and the economy will return to solid growth. Bulls will argue that a rebound will occur

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(Continued from page 1)

this summer as the markets have largely discounted the bad news. Bears will argue that this credit cycle is “different” and we could struggle for several years until housing, commodities, inflation, and the dollar stabilize. Recognizing that, as one of our Board members explains, “it is the mood not the math” that governs market action right now, I suspect it will be closer to year-end before we have a significant positive advance.

Indeed, corporate insiders are starting to be net purchasers of their own stock for the first time in thirteen years. Insiders are usually net sellers, as they need to raise money for their personal needs or have concerns about their company’s stock prices, such as the sales by internet company managers in 1999. Insiders seldom increase their exposure to their own companies unless they have a very positive outlook.

There are also a surprising number of the most successful long-term investors suddenly becoming bullish by opening their firms to new money. Managers, such as the teams at Longleaf Partners, Dodge & Cox, or Elliott Partners have opened for new investors after a long period of being closed. The best managers often need to close their funds when their superior performance attracts too much capital that would hurt their performance. The fact that some top tier managers are welcoming new capital suggests that they believe there are good places to put money to work.

Company stock price to earnings has reached very attractive levels for many names. The exceptional cheapness of the dollar is spurring exports thereby improving earnings for US multinationals and our current account deficits. Foreign investors are flush with the cash we paid for oil and consumer goods. While US investors have seen the price of their stock market decline 17% since last fall, a European investor holding euros has seen a 23% decline since June. A European investor with euros has seen a 50% decline since the peak in 2000. America is on sale for half price to foreign investors and to sovereign-wealth funds holding low yielding cash and bonds.

The major trends of global growth remain in force, despite the interim credit dislocations. Developing countries, with their emergent governments, surplus of young workers, and unrelenting consumer demand, will continue to outpace the developed countries. The GDP of the BRIC countries (Brazil, Russia, India, and China) will surpass the combined GDP of the G-7 within a few decades, and there are a host of other countries following quickly behind, such as Vietnam, Cambodia, Turkey, and Mexico. Any serious decline in those markets is an opportunity worth seizing as the balance of economic power shifts.

Indeed, while there are certainly more bad surprises ahead, and the complexity of the financial dominos could mean further declines from problems known and unknown, the core



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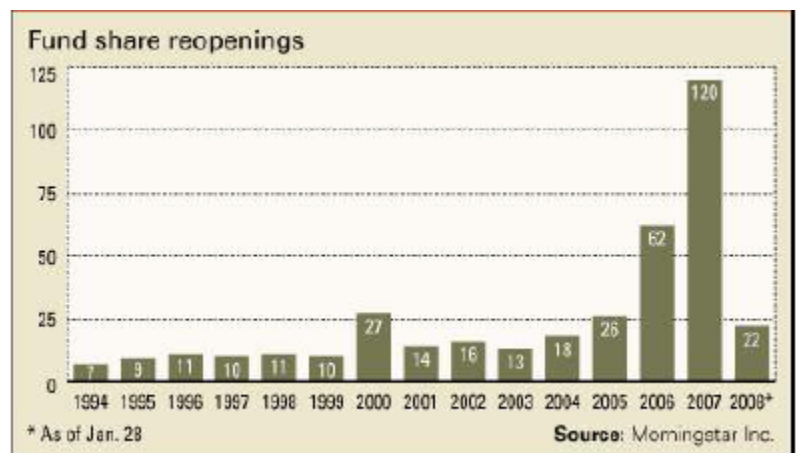
premise is to invest when prices are down and, as Rothschild famously explained, “when there is blood in the streets.” The current crisis presents opportunities for investors with time horizons of three years or more.

Investment Opportunities Abound?

By Bart Earley

One of the challenges we as advisors face in allocating clients’ capital is accessing the best money managers in the world. They are easy to identify and we know who they are. Unfortunately, at times, the best managers are closed and not accepting new investors.

However, in the span of just a few months, some of the most highly sought after managers in the world announced they are reopening their flagship products. Such highly regarded “value” shops like Dodge & Cox, Southeastern Asset Management (Longleaf Funds), and Harris Associates (Oakmark Funds) are open for new business. Vanguard cracked open the door to the talents of contrarian-minded Ed Owens of Wellington Partners, sub-adviser to Vanguard Healthcare (only for “flagship” clients who have \$1 million or more at Vanguard). Even the once-behemoth Fidelity Magellan reopened, under the auspice of portfolio manager Harry Lange.



Investments with all these managers may not make sense, but it still begs the question: Why are these firms re-opening their doors and what exactly do they see that’s so great? One reason may be that some of these managers have struggled recently and experienced net withdrawals from their products. However, we suspect this is not the primary rationale. After all, many of these firms have already demonstrated they are true stewards of capital and act in the best interest of investors. Simply gathering more assets is not a sufficient incentive. Here’s what these managers have told us about why they’ve rolled out the welcome mat to new investors:

“...the volatile investment environment has created what we believe to be many interesting long-term equity and fixed income opportunities.”

- the team at Dodge & Cox (Dodge & Cox Stock)



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“The opportunities have become more compelling. Lower prices are allowing us to buy more and high quality companies at larger discounts.”

- Mason Hawkins and Stanley Cates of Southeastern Asset Management (Longleaf Partners)

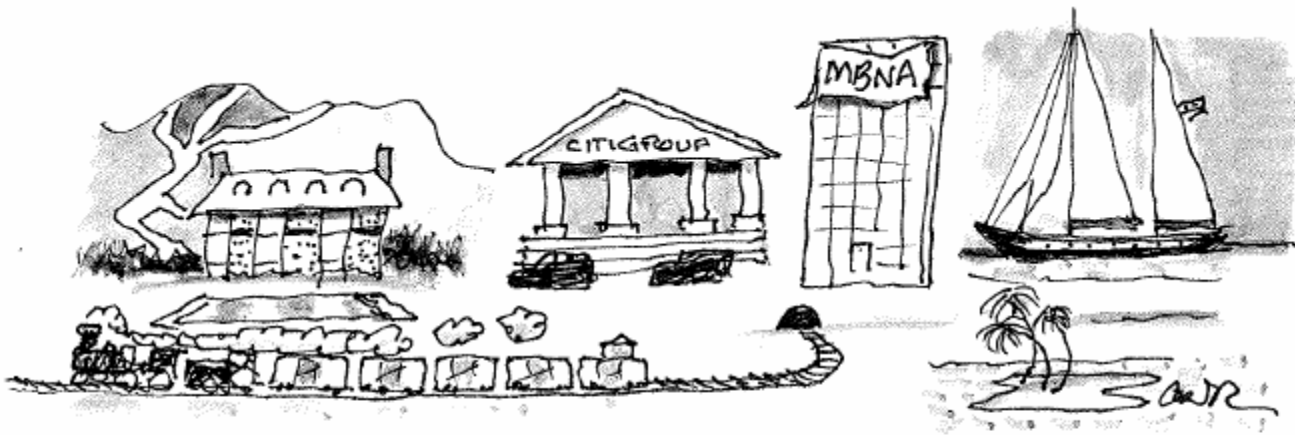
“We’re excited about the investment opportunities we’re seeing around the world...”

-David Herro of Harris Associates (Oakmark International)

The common thread among all these investing titans is *opportunity*. Many shops closed their doors several years ago due to of lack of opportunity, and after the sell-off of the past few months, they believe opportunities abound. The rewards may not materialize in the next few months, but given the outstanding track record of these firms, it is a safe bet that for several of these firms the opportunity to upgrade their portfolios will pay off handsomely for investors over the long run.

We cannot be certain when these managers will close their doors again, but if history is any guide, it will be when the opportunities are no longer present. Due to our open-architecture structure, we are able to take advantage of these manager re-openings and upgrade our client portfolios.

Let us know if you would like to receive our quarterly newsletter electronically.



“IT’S ALL FOR SALE,  WHAT WOULD YOU LIKE TO BUY?....”