



MANCHESTER

CAPITAL MANAGEMENT, LLC

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Process Instead of Panic

When I read the current newspaper reports of panic or listen to the television interviews of nervous investors not knowing whether to buy or sell, I find it in stark contrast to the sense of calm and clear purpose at the MCM office. Your investment team keeps working diligently, exhibiting a quiet composure created by a confidence in a proven process.

Global stocks markets have suffered dramatic swings over the recent quarter, as the “loose” money of the last several years dries up. In prior newsletters we mentioned that this excess liquidity had to come to an unhappy end for those that gambled interest rates would stay low. People borrowed money to buy homes which their income couldn’t afford. Bankers borrowed short-term money against long-term collateral, and the mismatch has caught them out when the value of the collateral was called into question.

Prestigious names have been tarnished. Goldman Sachs has seen several of its largest investment funds endure significant losses when their “expert” strategies went wrong. European blue chips, such as the BNP Paribas Bank, have had to deny investors access to their money market funds when the value of investment pools unexpectedly declined. J.P. Morgan’s key hedge fund, the \$56 billion Highland Capital, had to disclose losses triggered by an inability to value complex derivatives. These kinds of firms are not supposed to have these kinds of problems.

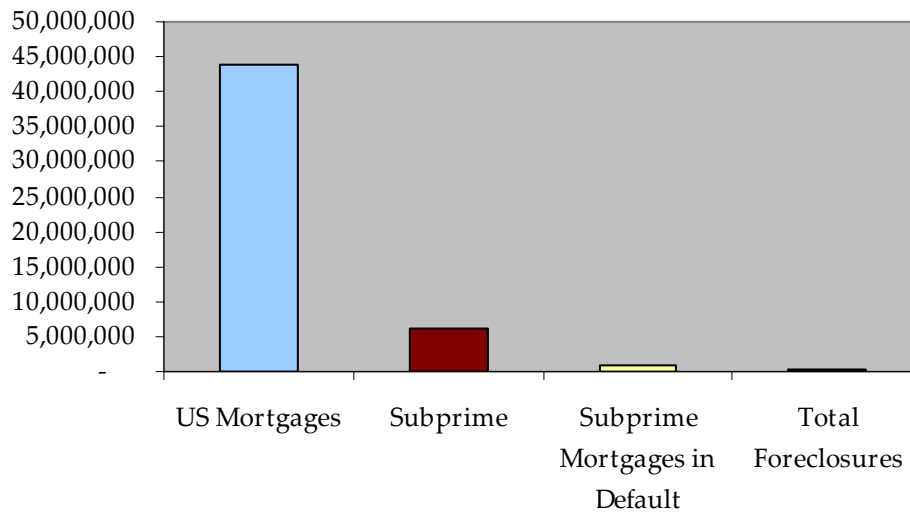
And the problems are not over. There is a complex world of sub-prime mortgages, collateral debt obligations, structured investment pools, conduits, credit derivatives, etc., that hold negative surprises. We expect several large hedge funds to close their doors. We anticipate that some of the most powerful and reputable institutions will be embarrassed. There has been an excess of financial engineering and a deficit of prudent lending.

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U.S. Mortgage Market



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Source: Mortgage Bankers Assoc

Trying to measure the extent of the potential problems is difficult. In many ways it should be less than, say, the savings and loan crisis of the 1990s. Only about 5% of the sub-prime market is in default (about \$67 billion), and the sub-prime is only 14% of the total mortgage market of \$10.4 trillion. The Federal Reserve, along with European central banks, has shown a willingness to step in and support the markets if needed. Domestic and global economic growth continues to be very strong. This is really a problem in a limited part of the financial markets. Credit spreads are still reasonable and credit worthy borrowers can still borrow money as needed.

While the interim market declines of 2001, 1998, 1994, 1987, etc., were traumatic at the time, investors look back with envy at the market prices available at those times. Expected returns of portfolios are improved when market prices correct. While well-designed portfolios declined modestly in the second quarter, they remain well ahead for the year.

The current blow to confidence caused by declining housing prices, the re-pricing of market risks, and the volatile swings in stock prices does impact consumers' willingness to spend and could lead to economic slowdown. The emerging markets have been so strong that, like the proverbial bean stalk, they can't keep growing to the sky. Indeed, there might be better buying opportunities in months ahead, but the odds and the history of the markets favor higher prices. We are calmly looking at how best to take advantage.

Ted Cronin, CIO



Recipe for 'A Correction'

Starting Ingredients (2001)

1 part economic recession	1 gallon of home and real estate purchasing
1 part falling stock prices	1 gallon of new home construction
1 part generation low interest rates	1 gallon of new mortgage lenders/originators

Additional Ingredients (2007)

A dash of increasing interest rates	1 gallon of greed
A pinch of adjustable-rate mortgages	1 gallon of lax lending practices
A dollop of variable-rate mortgages	1 gallon of highly priced collateral
A smidgen of interest-only mortgages	1 gallon of real estate speculation

Recipe

In 2001, mix together an economic recession, falling stock prices and low interest rates. Add baby boomer's children having families and buying homes. Add real estate buying and real estate speculation. Then, add new house construction and new mortgage lenders (preferably internet-based).

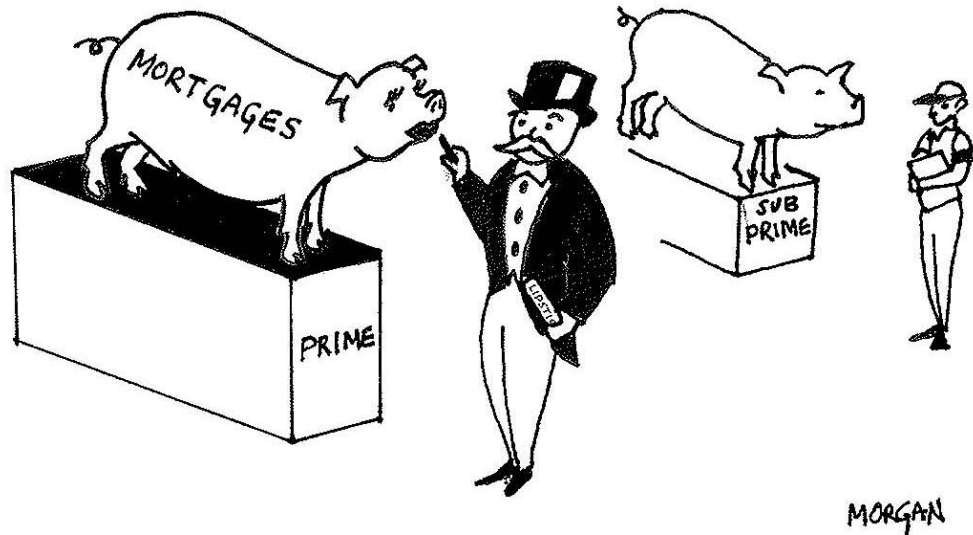
Let sit for a couple of years while slowly stirring in more new home construction, more real estate speculation, more second home purchases, more retirement home purchases, and more investment property purchases. No down-payment required.

In a separate bowl, mix together a profitable mortgage lending environment with new mortgage lenders/originators, greed, and looser lending standards. Then, add generation-low interest rates with adjustable-rate, variable-rate, reverse and interest-only mortgages (to taste).

Combine the two sets of ingredients into one pot and continue stirring while sprinkling in a little pressure to own your own home.

Put in the oven and wait until the economy and corporate earnings start to rise. When this happens, get ready because rising interest rates will soon follow.

Remove the pot from the oven and let it rest. Once interest rates rise and home buyers cool... voila, you have A Correction! When done, 'A Correction' makes a good 'Buying Opportunity' (see our next recipe to follow).



Inside MCM

Number Eight in the Country!!

We are pleased to announce that Ted Cronin, President of Manchester Capital Management, has been named the eighth best Independent Financial Advisor by the prestigious publication, *Barron's*. With over 5,000 firms in the country, we would be very proud to be represented in the top 100, let alone one of the top 10. According to *Barron's*, the ranking reflects each advisor's quality of service and assets under management.

In truth, the award belongs to our clients, not to us. You are the ones who make it possible for us to serve, and everything we do is focused on your individual goals and needs.

Barron's is the weekly publication of Dow Jones, and has been in operation for over 80 years, serving as the trusted record of the domestic financial markets. It remains today one of the most admired sources of data and opinion.

Jim Follows His Passion

After six years at MCM working in the investment arena, Jim Miranda recently announced his decision to change careers. He has joined a local renewable energy company, where he will help permit and develop wind mill projects. As he explained, "My real passion is working on socially responsible causes." We wish him every success as he pursues a new direction, and we will miss his wonderful personality and solid efforts.