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CAPITAL IDEAS

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“Hedge Fun”

The top 29 hedge fund managers made $29 billion in 2007 according to The New York Times.

No wonder every kid wants to be a "hedge fund manager!" What about doctors and teachers.......my guess is that the top 50 teachers made about $5 million…

The "crude" reality is that it is now more difficult to get black gold out of the ground in Saudi Arabia with great demand from China, India and developing countries and oil prices may be headed for continued new highs…it is mind-boggling that the United States has yet to develop a comprehensive national energy and conservation policy.

Meanwhile, the falling U.S. dollar is on everyone's mind, yet no one wants to address the real problem.

In the 1970's, petrodollars, the money earned by oil exporters, were used to buy U.S. Treasury securities. This created a natural support for the U.S. dollar. Over the past number of years, oil exporters have been diversifying away from the U.S. dollar.

"Greater Europe" and Japan have been the beneficiaries of this diversification. Imports of products by oil producing nations have grown by over 40%, while imports from the U.S. have fallen 10%. The oil exporters are buying much more of their products from others. In short, American industry has fallen behind.

I wrote several months ago that high oil prices were good for this country because petrodollars were funding our deficit (and now funding the correction of the sub-prime mess) and thus our dollars were being repatriated. The real risk in this is the purchase of large blocks of U.S. companies by sovereign wealth funds.

Remember, that we live in a country that mostly reacts to crisis as opposed to taking initiative before crisis occurs.

In reality, the high oil prices are forcing us to do what we SHOULD HAVE BEEN DOING for many years—finding a solution!!!

Ultimately, this will be a positive…remember, no pain, no gain.

As I write this letter, I am in Israel. The Palestinians are hosting a conference inviting companies to learn about potential investment opportunities in their land.

The fact is that only through economic progress and raising the standard of living can a regime exist and perpetuate itself. We view this as a positive sign and believe that these kinds of conferences, and hopefully the ensuing investments, will make it easier for peace to prevail.

The U.S. economy is having a difficult time no matter how one were to label it. We have a 23 year high inventory of unsold homes, a 49 year low in per-capita home sales, a 28 year low in consumer confidence, and an all time high in inflation adjusted oil prices.

Now for the market reality—the S&P is at the same level as it was nine years ago!

When Mr. Greenspan bailed out the hedge fund "Long Term Capital" and smoothed the shock wave caused by the Russian debt crisis that same year (1998), he in effect rewarded investors for assuming risk and losing.

Then we approached the year 2000, and EVERYONE was worried about the Y2K. The hypothesis was that computers would cease functioning, “planes would fall from the skies and utility plants would shut down" and a lot of other poppycock!!!

In response, the Federal Reserve made funds abundant, which ultimately resulted in the excessive use of credit.

If nature had taken its course, the natural cycle would have led us to a healthy recession in the late 90's, which would have flushed the system of its excesses.

What did happen, however, was a continuation of “the party” and the continued extension of credit (indiscriminately at times) and, thus, here we are.

As the system goes through a period of de-leveraging (which may last a few years), Americans will feel further pain and our standard of living may decline as we are forced to reduce debt and to and use less energy.

The world has 6.7 billion people. The demand for resources from our planet is exploding. By the next generation, the population is expected to reach 9 billion people. The message is "start conserving now"!!!

We continue to like the energy and natural resource sectors (including water), infrastructure plays and basic consumer franchises.

As we also believe that interest rates are not likely to move lower, we are cautious about the maturities in our bond portfolios.

The markets, in our view, are likely to remain volatile. Better leadership and clearer policy from Washington would help, but that is not likely until late 2009, one year after the elections (if ever!).

Stay well diversified and extremely cautious in your financial decision making.

Just remember if you are looking for big opportunity, seek out a big problem. We are always looking!

As always,

Seymour W. Zises

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