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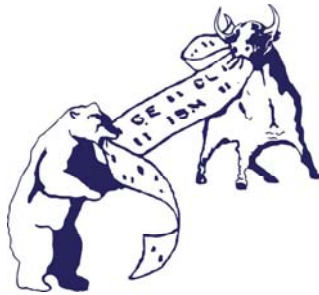
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To Our Valued Clients & Friends:



*Written the weekend of
February 29th:*

I know I am a bit early with our first letter of the year, but it has been such an interesting two months that I didn't want to wait another month to comment on several items that have affected our thinking and resulted in our taking a more defensive position in early January. I offer you a few observations and thoughts:

Gas prices

Gas prices have broken through the \$3 a gallon level, and the possibility of gas prices reaching \$3.50 a gallon or more by summer has become a very real possibility. The reason for this rise appears to be a combination of trading speculation and our falling U.S. dollar. (Remember oil is traded in U.S. dollars.)

Inflation

Although the government does not want you to be alarmed by the prospects of an increase in inflation, as they are always tinkering with the inflation measuring index, the prospect of inflation becoming a very real problem in this country is becoming apparent. A seldom-followed "Alabama cost of living index" was released last week revealing a 1.6% monthly increase in the cost of a determined basket of goods and services here in Alabama. If my math is correct, that represents an annualized 19.2% increase in the cost of living here in our state.

Last week, the U.S. Government's own Consumer Price Index (CPI) was up 1% for the month with an annualized rate of 12%, which I find suspect. I believe the government has selectively adjusted this index in a way that underestimates the data being presented. As an example, rent cost was removed from the index about 6 months ago. With the enormous increase in home foreclosures, the demand for apartments has led to rent increases.

While the cost of home ownership has fallen, the CPI ignores the increased rent cost for those needing apartments. The index will report only modest inflation in this area due to the downward pressure provided by falling home prices. This will clearly understate the inflation rate, which is used to adjust social security and many labor contracts.

A final word regarding the Consumer price index: The index is up 7% over the last six months, which is the largest increase in over 26 years.)

Home prices

Home prices fell between 16% and 18% in most



metropolitan areas across the country in 2007, and the prospects for another dramatic fall in home prices appear to be in the cards for 2008. I believe the decline in home prices is far from over in specific

areas of the country. Yesterday, Broward and Dade Counties in Florida, which historically have about 6,000 homes on the market with monthly sales of 4,900 properties, reported 82,000 homes and condominiums on the market and sales for the month of January of 1,700 units. (That is not a typo.)

Turning to our own **Florida panhandle**, an observation from a seasoned developer: With existing housing and condo inventories in the panhandle, it may be **10 years** before developers can justify new projects for the area. (I believe we are at least two to three years away from a bottom in Florida Real Estate.)

The Consumer

Although home values continue to fall, the consumer apparently has not altered his or her spending habits. Consumers are now turning to credit cards to make those special purchases or using their cards simply to make ends meet. **Credit card debt** is on the rise after declining in 2006. Some consumers, who have already maxed out both their home equity lines and credit cards, are going directly to their 401K plans for funds. Hardship withdrawals are up 17% for 2007, according to Fidelity Investments, and plan loans are up 13% for the same period. (401K loans had fallen by 15% in 2005 and 2006.)

The American Consumer seems to continue to “live for the moment” with little concern for the future.

The U.S. Dollar

Last week, the Euro rose to \$1.52, which is an all time high. Looking back over the five years, the Euro was trading at an average of .94 cents and the Canadian dollar was trading at .64 cents. Now the Euro is at \$1.52, a 61% loss in value for the U.S. dollar, while the Canadian dollar is trading at par, or \$1.00. The bottom line is that items purchased from these two trading partners have risen in cost to U.S. citizens by over 50% in the last five years.

Some may argue that by having a **weaker dollar** our products become cheaper in the International market, thus improving our trade deficit. They may be right as this policy could be effective, if only the country could curtail its insatiable appetite for international goods and services. Since 2002, our trade deficit has continued to bloom. As an example, in 2002 with the Euro being only 94 cents, our trade deficit with Germany was \$36 billion, but now it's grown to more than \$45 billion in 2007 even with a cheaper dollar. In the same year, our trade deficit with Canada was approximately \$50 billion, but it has now ballooned to \$64 billion. A cheaper dollar does not alter the trade deficit direction if we

continue to consume everything in sight. Our trade deficit currently runs at **\$2 billion a day**. It requires American business to force feed \$2 billion in U.S. dollars to the International markets each day, which must be converted to foreign currencies or retained in the United States as a Euro dollar investment. (A Euro dollar is a U.S. dollar owned by someone other than a U.S. citizen.) This spending spree and weak dollar policy will fuel inflation and continue to add to the declining value of the U.S. dollar.

This morning Warren Buffet appeared on CNBC and provided an excellent analogy for this situation. Because the U.S. Economy is so enormous and because our country has the ability to print money, even though we offer nothing to back it up beyond our good name, we can continue on this massive consumption spree for a long period. If one could picture a single family owning a ranch the size of Texas who had spending habits that resulted in them spending 105% of their income each year and then mortgaging a small portion of the ranch each year to pay for that extra 5% of consumption, things would appear to be just fine for quite a while. Unfortunately, there will be a day of reckoning where so much of the property, or the farm, is mortgaged that the remaining assets of the



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farm will find it difficult to service both the debt and provide income for the family.

This example may be appropriate for our economy as no one can tell that we are actually heading for bankruptcy because of our ability to print IOUs. Nevertheless, we continue to be more and more dependent upon foreign investors and their willingness to accept and hold our currency. There may be a point that our trading partners will refuse our currency and investments and insist on a much higher rate of interest to reflect the risk associated with holding the U.S. dollar. Our current U.S. debt exceeds \$9 trillion and the only reason that interest cost is not overwhelming our federal budget at this time is because interest rates are at an historic low. The majority of bond debt is shorter than ten years, bringing our overall interest cost down, but also reflecting a short maturity schedule. Can you imagine what will happen if interest costs double and such a large portion of our national debt would need to be refinanced quickly? Do you think it would be possible for our economy and government to absorb a doubling of interest cost on \$9 trillion of debt?

Well, this is a scary scenario—suggesting the average consumer is being pressed against the wall and the country is

spending itself into oblivion. Nevertheless, take a deep breath here, the economy will survive, but I believe that we must be prepared for a prolonged downturn in the economy. The Real Estate bubble took 15 years to develop, and during that period the appreciation of homes far exceeded their historic average increase each year. The bubble has collapsed, but the difference between the Real Estate bubble collapsing now and the NASDAQ Stock market collapsing between 2000 and 2002 is that the housing collapse will affect far more people. And while the NASDAQ bubble collapsed the value of people's portfolios, investors had an offset on their balance sheet with the increase in home values to fall back on. This collapse in home prices leaves no offsetting increase in assets to soothe the consumer.

Beth and I were talking Sunday, and we stumbled across an interesting observation. As we were walking through our neighborhood, we thought about the substantial homes and mortgage debt that has been incurred by many young couples over the last several years. It has not been uncommon for a couple in their 30s to be granted a seven-figure mortgage at a teaser rate as low as 2 to 3 percent. In addition, this couple, with their nice new home, often went out and purchased two large SUVs with zero

interest financing available. As a result, two \$50,000 SUVs sit in their driveway. Finally, we couldn't help but notice that furniture stores allow one to come in and furnish an entire home without having payments due for 2 or even 3 years. Perhaps most importantly, each of these debts, the mortgage, car loans, and the furniture package has been **securitized**. The institutions originating the loans are packaging these loans and selling them into the secondary market as securities. This is what the sub prime mess is all about.

The couple is able to take on twelve times more debt, approximately \$1.2 million, compared to their equity of perhaps a 10% down payment on their home. All it will take is a slight "bump in the road" to place this family in an upside down position. One small "bump in the road" and payments on any portion of the various pieces of securitized debt begins to deteriorate the quality of the debt. Thus, the sub prime problems. (The debt may have been sold to an international bank. How do lenders and borrowers communicate when there is a problem?)

I am not going to leave you on a negative note! A quote from Mr. Warren Buffet yesterday: "Usually, historically, when we go into recessions, it's been better to buy stocks right at the front end of recession than when we



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are deeply into them. Stocks usually bottom out well before the recessions bottom out. This is actually a pretty good time to be stepping into the market and buying some value plays."

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Conclusion

You will recall that in the fall of last year we made alterations in our balanced accounts to reflect higher positions in cash, bonds and commodities. This move has been supplemented in mid-January to add a foreign bond position, not only in our balanced accounts, but also in our growth and

moderate growth accounts as well. I am pleased to report that these alterations have assisted in softening the blow of a 9% dip in the S&P 500 during the first two months of 2008.

In closing, this morning, I report to you that the Euro has hit \$1.53 and that oil prices have now passed the \$105 a barrel mark. My major concern continues to be that these high gas prices will indeed hurt the American consumer, which can prolong this recession. To me it has become obvious, even though

economic reporting has yet to catch up, that the country is indeed in a recession already. We will continue to maintain our conservative stance in your portfolios, and we will continue to watch for key stock indicators that may suggest the beginning of a rebound of economic activity.

I look forward to speaking with you during the next quarter.

Warmest Regards,

M. Brooks Clark

Numbers Of Interest

	Price Today	1 Year Ago	% Change
Gas	\$3.16	\$2.50	26.4%
1 lb. bread	\$1.28	\$1.15	11.3%
1 dozen eggs	\$2.18	\$1.55	40.6%
1 gallon milk	\$3.87	\$3.07	26%
1 lb. cheese	\$4.62	\$4.06	15%
1 lb. tomatoes	\$2.03	\$1.62	25%
Corn	\$4.78	\$3.31	44%
Soybeans	\$11.85	\$7.11	66%

P.S. Don't worry...the government says the CPI increased from 202.4 in January of 2007 to 207.3 in December of 2007, an increase of only 2.42%.

If you would like to have a copy of your statement from Clark Financial Advisors listing all of your accounts and their current values emailed to you, please email Amanda and she can update your statement and email it to you as a PDF.

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