

Van Sant & Mewshaw Inc.

Registered Investment Advisor

Common Sense Advisor ©

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MARKET MANTRA

Analysis/Commentary

Recently we have found ourselves basking in the glow of our own ignorance. Many times we have declared our belief that professed ignorance is a virtue. Now, we acknowledge “professed ignorance” might not yet be ready to be added to the Dalai Lama’s list of ten virtues. However, it does serve as a concrete example of the wisdom in the axiom, **“Never invest your money in something you don’t understand or you can’t explain in less than**

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NEWS AND UPDATES

Address Changes/Snowbird Migration

If you need to change your mailing address please contact our office. We can prepare the necessary paperwork so that both VSM & Charles Schwab have the correct information. This way any correspondence, including monthly and quarterly statements will not be delayed.

IMPORTANT! IMPORTANT! IMPORTANT!

If you are a snowbird and about to begin the migration to warmer weather, please **remember to inform us to change your address of record on your accounts.**

Required Minimum Distributions

If you are required to take a minimum distribution from your IRA for tax year 2007 the distribution form will be mailed to you in the near future.

IMPORTANT! IMPORTANT! IMPORTANT!

Please return these signed forms to the VSM office promptly so that we may process them in a timely manner. Please notify our office if you are over 70½ and have other qualified IRA assets held outside of Van Sant & Mewshaw purview. This will allow us to calculate the correct distribution. Account holders that have reached the age of 70½ in 2007 must take an RMD by April 1, 2008. After an account holder takes the initial RMD, all future RMDs must be taken by December 31. If you have any questions please call Sara Bowser.

Year-End Planning

As the year draws to a close, we will be busy reviewing accounts for tax-planning, portfolio rebalancing and other related issues. Should you have questions or would like to schedule a year-end review please call your investment counsellor to arrange an appointment.

Returns 2007

INDEX	3RDQTR	YTD
S&P 500	+1.60%	+7.60%
Dow Jones Industrial	+3.90%	+11.50%
Nasdaq	+4.00%	+11.80%
Russell 2000	-3.50%	+2.30%
Foreign Stocks	+1.80%	+10.90%
Enhanced Growth	+1.27%	+9.51%
Growth	+1.56%	+7.90%
Moderate Growth	+1.69%	+6.91%
Conservative Growth	+1.78%	+5.36%
1YR T Bill		+3.90%

For information about our Managed Account Services we can be reached at (410) 825-8844

Minimum Account Size \$150,000.00

two minutes”. This has proved to be especially wise advice with regard to the current crisis in the credit markets. The instruments which are at the center and the cause of this financial-credit market morass are Collateralized Debt Obligations (CDOs) consisting of subprime mortgages. Not too long ago we were solicited by a salesman from a Wall Street firm touting the benefits of these CDOs. We were advised that we were out of step with the modern world of investing. That we could provide our clients access to these sophisticated investments through the use of hedge funds with names like *High Grade Structured Credit Fund*, *Credit Strategies Fund*, or the *Enhanced Leveraged Fund*. These opportunities were offered by such prestigious firms as Bear Stearns, Deutsche Bank, Merrill Lynch and many more of the usual suspects. We were assured these funds would provide higher returns with very little risk. In an overt display of our ignorance, we naively asked, “How can there be higher returns with less risk?” We didn’t understand. We were told that these funds were created by using complex and elaborate mathematical models which only the most advanced minds on Wall Street could comprehend. Furthermore, because there was no real market for these complicated inventions they could not be “marked to the market” at the end of the day like a normal investment. They would be “marked to the model” (*Say what!?*); that is, their value would not be based on the market prices, but on a mathematical formula concocted by the same people who created and sold them (this is akin to allowing the high school football team to grade their own senior essays!). Not only did this not sound like a good idea, or some type of scam, it sounded like something for which somebody could go to jail. Like most, we were totally unaware of the depth of our ignorance with regard

to these Wall Street implements. Hence, we took a pass on the opportunities being offered. But in the spirit of public service we offer our own guide to the world of subprime mortgage CDOs.

Subprime Mortgage: Mortgage issued by a lending company to gullible consumers who borrow recklessly to buy homes they cannot afford and have about as much a chance as paying it back as Michael Vick has to becoming the next Dog Whisperer.

Gullible Consumer: Politically correct term for rube.

Subprime Underwriting Process: The process of determining the risk involved in a particular loan, based on the borrower’s ability to make some semblance of a scribble that could be taken for a signature, and is not disqualified by being in prison (we’re not making this up).

Subprime Underwriting Fees: Outrageously high fees extracted from the loan and paid immediately to the underwriter; including fees for flood insurance for property in Arizona (we’re not making this up either).

Subprime Underwriter: Politically correct term for huckster.

Tranche: Mystifying process in which Wall Street firms create CDOs by gathering and packaging a group of subprime mortgages with higher quality mortgages and calling the whole thing investment grade.

Securitization: The process in which crappy investments are made to look like first rate and then sold to unsuspecting investors (In Wall Street jargon this is known as “Putting lipstick on a pig”).

Unsuspecting Investor: Politically correct term for bag-holder.

AMERICAN HOME MORTGAGE INVESTMENT CORP: LACKED PROFESSED IGNORANCE



NOTABLE QUOTES

"I foresee a 25% peak-to-trough decline in median single-family house prices nationwide. Remember, the earlier leap in prices was so exuberant that it would take a 50% fall to return them to post-World War II norm, after adjusting for inflation and the increasing size of houses. I'm also forecasting a 60% peak-to-trough decline in existing house sales—a forecast that many view extreme. But between November 1978 and May, sales fell 55% in what was a much less severe housing slump than is ongoing today. The global recession that I expect to result from the spreading subprime slime, global de-leveraging and speculative bubble-breaking will benefit stocks by reducing inflation fears and thereby Treasury yields, aided by the usual Fed ease. But as is normal early in the recession, plummeting profits will more that offset those salutary effects to the detriment of stocks. Stocks at home and abroad are suggesting that worldwide problems lie ahead. Meanwhile, the leap in expected stock volatility indicates a newfound appreciation for investment risk, another drag on equities. I suspect that a full-blown bear market is starting, or soon will." (A. Gary Shilling's Insight, 8/2/2007)

"During the height of the real estate bubble, mortgage lenders were often shameless in how they pursued new business. Whether it was jacking up hidden closing cost to make loans appear cheaper than they were or using absurdly-low teaser rates on option or interest only ARMs to get customers in the door, lenders made owning a home seem easy. To easy. Fast forward a couple years and mortgage defaults are skyrocketing. Foreclosures were up 90 percent in May alone, according to Realty

Trac. And lenders are finally realizing that coaxing consumers to borrow more that they can really afford is, as business strategies go, just plain dumb."(Jon Birger, *Desperate Measures for the Mortgage Business*, *Fortune*, 6/18/2007)

"The dollar is falling. So far this year, investors have lost about 4.5% in dollar-based assets, compared to the euro. That effectively wipes out an entire year's worth of earnings for Treasury bond investors, for example. The typical American barely notices; but the overseas speculator feels every slight drop in the dollar like a bee sting. And the risk to the world financial bubble is that he might go into shock." (Bill Bonner, *The Daily Reckoning*, 7/23/2007)

"The national foreclosure wave , meanwhile, may soon become a tsunami. Some \$120 billion in adjustable-rate mortgages are scheduled to reset at higher interest rates in the next three months. Subprime adjustable rate loans make up \$90 billion of that." (Gretchen Morgenson, *Can these Mortgages Be Saved*, *New York Times*, 9/30/2007)

"The truth, indeed, is something that mankind, for some mysterious reason, instinctively dislikes. Every man who tries to tell it is unpopular, and even when, by the sheer strength of his case, he prevails, he is put down as a scoundrel." (H.L. Mencken)

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I WANT YOU TO WRITE A BUSINESS CASE FOR LOBBYING OUR GOVERNMENT TO ATTACK ELBONIA.



www.dilbert.com scottadams@aol.com

IN THE RISK ANALYSIS SECTION, DO YOU WANT ME TO ASSUME THAT HELL IS REAL OR IMAGINARY?



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REAL. BUT REMEMBER TO DISCOUNT THE INFINITE FUTURE FLOWS OF AGONY TO THE PRESENT SO IT DOESN'T LOOK SO BAD.



Passive Portfolio Allocations
September 30, 2007

FUND	ENHANCED GROWTH	GROWTH	MODERATE GROWTH	CONSERVATIVE GROWTH	RETURN 2007
U.S. Stocks Large Cap	65.00%	50.00%	40.00%	30.00%	+9.05%
U.S. Stocks Small Cap	15.00%	10.00%	8.00%	5.00%	+6.51%
Foreign Stocks	20.00%	15.00%	12.00%	5.00%	+16.98%
U.S. Bonds	0.00%	25.00%	40.00%	60.00%	+3.70%
	—	—			
Return Thru 09/30/07	+9.51%	+7.90%	+6.91%	+5.36%	—

THE PURPOSE OF PASSIVE ALLOCATION

Passive Allocation reflects a logical, static, strategic asset allocation for a hypothetical long-term investor who is not using active asset allocation. It is based on our evaluation of the historical long-term risk and return relationships of the asset classes, and what we consider to be realistic and reasonable expectations going forward. It is the starting point for our active asset allocation process.

The passive allocation is the asset allocation that we will implement when our conviction level about any specific asset class is not high enough to justify changing the asset allocation mix. It gives us a sensible long-term allocation, based on sound research. It gives us a constant frame-of-reference against which to measure decisions. For example, if our research shows small cap growth stocks are at historically undervalued levels, we must decide what they will replace in the portfolio and how far from passive we will stray. This will be a function of our confidence and the impact on the portfolio's risk and return potential. The permanent frame-of-reference imposed by the passive allocation increases the odds that we will consistently apply our methodology. The passive allocation will serve as a benchmark against which to measure our value added.

Passive Portfolio Allocation Historical Risk/Return

PORTFOLIO TYPE	RISK LEVEL 12 MONTH LOSS THRESHOLD	TEN-YEAR AVERAGE RETURN	WORST 12 MONTH ROLLING RETURN 1976 THROUGH 2006
Enhanced Growth	-20%	8.17%	-26.71%
Growth	-15%	8.01%	-17.31%
Moderate Growth	-10%	8.14%	-11.64%
Conservative Growth	-5%	7.40%	-5.32%

Passive portfolio results reflect only hypothetical returns and may differ significantly from results achieved for actual managed accounts. Passive portfolio results reflect reinvestment of dividends, other earnings and the deduction of fund expenses and management fees. Complete descriptions of accounts and transaction history is available upon request. Van Sant and Mewshaw, Inc makes a good faith effort to highlight and summarize certain economic, market, and other data to assist their clients in structuring investment portfolios. This report should not be construed as advice meeting the particular needs of any investor. Investors are advised that past performance is no guarantee of future results. Historical data provided by Morningstar; beginning in September 1976 through February 2007