

## Cornerstone Money Management

### Key Points

- ◆ Cornerstone *Xtreme* is designed to take advantage of current financial crisis
- ◆ *Xtreme* will utilize stocks, bonds mutual funds, ETFs and Options
- ◆ *Xtreme* will not short, but will utilize investments that will benefit from shorting, such as Short ETFs



As Seen in  
**Forbes**

Cornerstone Investment Services has been chosen by Goldline Research as one of the **Ten Most Dependable Wealth Managers of the NorthEast**

Introducing

## Cornerstone *Xtreme*

Cornerstone *Xtreme* is a managed portfolio designed to take advantage of the current financial and economic crisis. It is a fully flexible portfolio that will invest in stocks, bonds, ETFs, mutual funds and options. The proactive strategy will be implemented by the reputable and unconventional manager of the Cornerstone Model Portfolio, John Riley.

### Background:

Investors have begun to realize that the economy and financial system are at risk more now than they have ever been in their lifetimes. This means that unless an investor changes their investment strategy, they could be left out in the cold or worse, decimated by the potential economic collapse.

With traditional brokers, investors have two choices, to either hope to ride out the crisis and take their lumps, or to move to the sidelines and sit in cash.

Now they have a third option. They can look the economic monster right in the face and attack it in a way they have never been able to before.

The Cornerstone *Xtreme* portfolio is designed to take advantage of the downside of various markets. It will attempt to exploit the policies of the Fed that are doing long term damage to the economy. Trading strategies will turn market volatility into an advantage for the *Xtreme* portfolio.

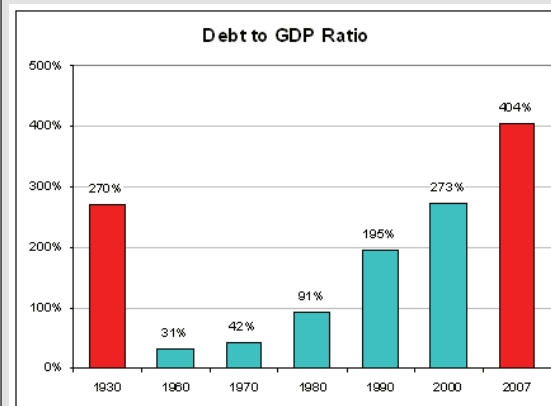
### Economic Backdrop:

There are four main problems with the current US economy. They are Debt, Derivatives, Deficits and the Dollar.

### Debt

The current Debt to GDP ratio is the highest it has ever been, higher than just before the Great Depression. The unwinding of this debt will take years and take money away from economic growth and the stock market. Unfortunately for the economy, the Fed doesn't understand the problems with the mountain of debt in the economy since virtually everything the Fed has done this year, with all of the bailouts, takeovers and handouts, have increased debt levels, not decreased them. This should keep the economy down and the stock market from making any serious gains until the debt to GDP ratio is down to a manageable level.

### Debt compared to GDP



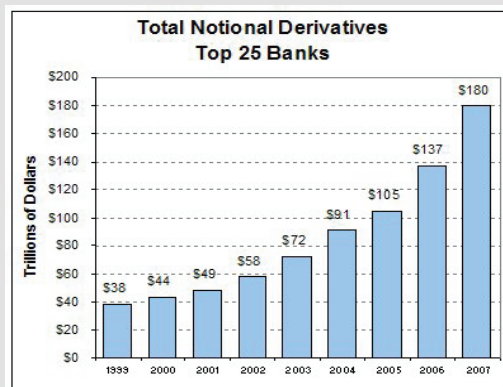
Source: Federal Reserve; Format: CIS

The Debt to GDP Ratio is the highest since before the Great Depression. In order to reverse this, the economy either has to grow extraordinarily, or debt levels must come down substantially. Negative debt growth would negatively impact the economy and markets.

### Derivatives

These financial time-bombs have caused much of the problems with the failed banks and brokerages this past year. Unregulated and gigantic in size, these esoteric financial instruments are understood by very few but have the potential to bring down the biggest banks and brokerages, along with the economy. Don't be fooled, banks have continued to increase their derivative holdings even in the face of the current economic crisis. JP Morgan alone added about \$7

### Derivative Growth Continues...



Source: OCC; Format: CIS

The use of derivatives just keeps on marching upwards. It is so out of control that the growth of derivatives in just the 2nd quarter of 2008 at the 3 big banks almost equaled the entire US GDP.

## Key Points

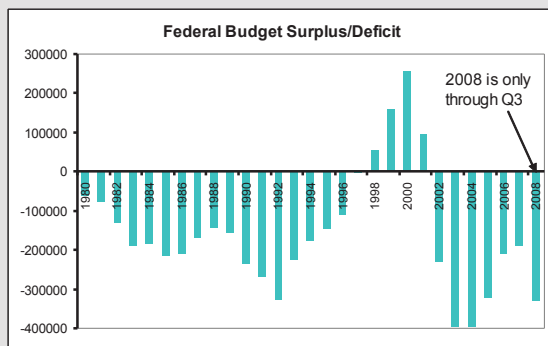
- ◆ Debt to GDP at Pre-Depression levels
- ◆ Derivative use growing unchecked and unregulated.
- ◆ Federal Budget Deficit growing due to bailouts
- ◆ Municipal Deficits growing as tax bases decline and liabilities expand
- ◆ Trade Deficit growing thanks to America's unquenchable thirst for foreign goods

TRILLION to its derivative portfolio in the 2<sup>nd</sup> quarter of 2008. At this point, everyone was well aware of the unfolding economic and financial problems and Bear Stearns had failed in the 1<sup>st</sup> quarter.

### Deficits

The Federal Budget Deficit is about \$400 billion so far this year and estimates are for it to reach \$1 trillion in 2009. The rising deficit forces the Treasury to sell more bonds to finance the deficit, driving long term interest rates higher and bond prices lower.

### Federal Budget Deficit



Source: Federal Reserve; Format: CIS

Since 2002, the Federal Budget Deficit was with us once again, putting a drag on the economy. It had been declining in the past several years though.

With all of the bailouts and takeovers, if the budget deficit likely to shrink or grow? By the 3rd quarter of this year, the budget deficit is already the highest it has been in 4 years. Some estimate next year's budget deficit could reach \$1 trillion.

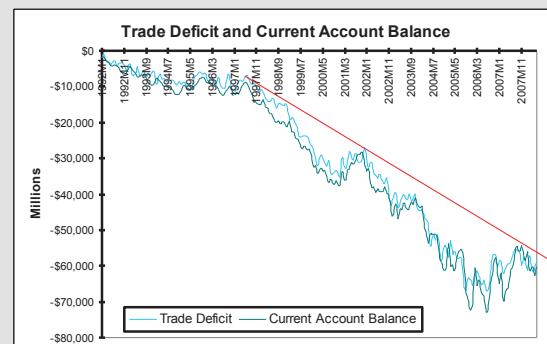
Local and State governments are also facing deficits that will not be easily paid down thanks to declining real estate prices reducing their tax base and the slowing economy reducing income tax and sales tax receipts. Muni bond offerings should rise as states and local municipalities are forced to finance their deficits with borrowed money. This increase in debt offerings along with the potential failure of the two major muni bond insurers should have negative impact on bond prices and send long term rates higher.

The Trade Deficit and Current Account Deficit are indicative of the reliance the US has on the generosity of foreigners. Thanks to our voracious appetite for all things made overseas, foreign countries have ended up with piles of US Dollars in their coffers and Treasuries in their banks. They would like to exchange those Dollars into their own currency, but thanks to the declining value of the US Dollar, this has been a difficult proposition for many countries. The risk is that some countries start dumping Dollars and Treasuries sending the Dollar crashing and long term interest rates skyrocketing.

### The Dollar

The US Dollar has been in a bear market since about 2002. The recent rally of about 15% is curious since just about everything the Fed has done to bail out the banks, brokers and everybody else, has been dilutive

## Trade Deficit and Current Account Deficit



Source: Federal Reserve; Format: CIS

The weakening Dollar was supposed to alleviate the Trade Deficit. It didn't work that way. As the Dollar fell for the past 5 years, the Trade Deficit kept going lower too. The recent uptick has given some hope of a reversal, but a strong Dollar is already showing it is dashing those hopes.

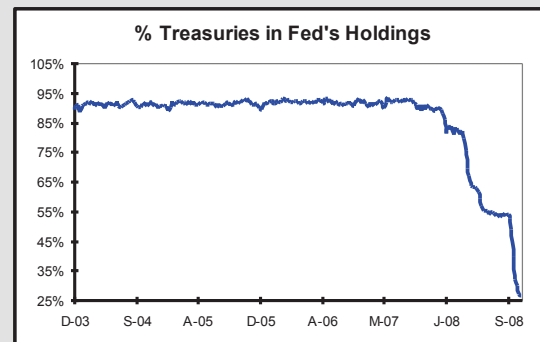
Foreigners may not want to hold Dollars for much longer as our economic and financial woes deepen.

and eroded the value of the Dollar. How many companies can the Fed bail out? Can they bail out everybody? Will their printing press keep cranking out more Dollars forever?

We believe the Dollar is the key to everything previously mentioned. Normally, everything the Fed has done would drive the Dollar lower. Even though the Dollar has instead rallied, we believe that fundamentals always win and that the errors of the Fed's policies will eventually result in the collapse of the US Dollar.

A Dollar collapse would send long term interest rates higher. The economy would stall and fall into recession or worse while the bear market in stocks would head lower. Inflation would heat up, possibly even to the point of hyper-inflation. Commodities and hard

## Eroding the Value of the Dollar



Source: Federal Reserve; Format: CIS

Over the past 12 months, the Federal Reserve has systematically eroded the value of the Dollar. Historically, Treasuries had been the staple of the Federal Reserve's Balance Sheet, accounting for 90 - 95% of their assets.

Now only 26% of the Fed's assets are in Treasuries. This is what is backing the Federal Reserve Notes in your pocket.

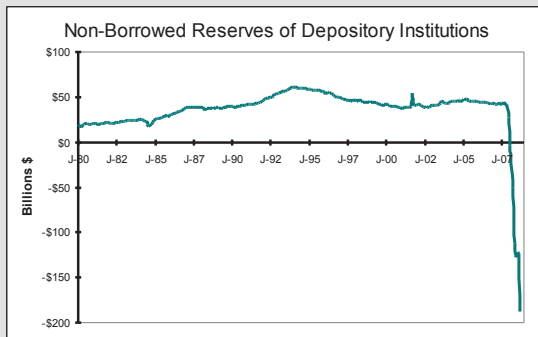
Is it any wonder we believe the current Dollar rally is not based on fundamentals?

## Key Points

- ◆ Fed's actions have eroded the value of the US Dollar
- ◆ A collapsing currency usually brings with it hyper-inflation

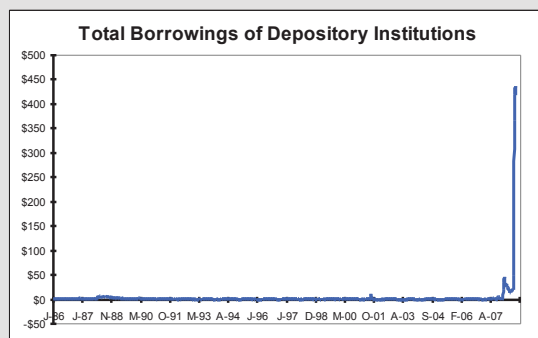
assets would benefit from a falling Dollar as investors run to "real" investments and shun paper assets.

### The Fed Saves the Banks With More Debt



Source: Federal Reserve; Format: CIS

In the past year, the reserves at banks have been wiped out and replaced with debt.



Source: Federal Reserve; Format: CIS

The Fed has lent over \$400 billion in the past year. The printing presses are working overtime!

## Strategy

The Cornerstone *Xtreme* portfolio is designed to take advantage of the problems listed above. Never before in history have investors had so many choices of investments and vehicles that could profit from market declines and economic disruptions. Today investors don't need to be fearful of a bear market, but embrace it with the proper investment strategy.

The first parts of the strategy are Index shorts. Cornerstone will utilize a variety of vehicles to profit from the declining markets including ETFs, mutual funds and options. (Cornerstone will never actually go short any investment.)

The next parts are sector shorts. These will focus on certain sectors from currencies to interest rates to industries. Again, as with the Index shorts, we will utilize ETFs, mutual funds and options.

Since we believe the US Dollar is a key to much of the future problems in the United States economy, we will have a significant portion allocated to gold and gold

mining companies. As the Dollar declines, gold should advance and the miners are currently cheap relative to the metal.

The next portion is allocated to US Treasuries as we believe this could be a volatile area. We will lengthen and shorten maturities as our strategy indicates, attempting to capture some gains on the volatility of the long end of the yield curve.

The last part of the allocation is focused on trading. Both long term and short term strategies will be used. This part of the portfolio will be open to trading stocks, bonds or ETFs. When not invested, the money will be in a Treasury money market.

### Buy n' Hold is dead

The allocations will not be static nor will the holdings be static. We will constantly be monitoring the allocation and making adjustments as our strategy requires.

For instance, we will not hold short index ETFs forever. If it appears that the market is ready for an intermediate rally, we may reduce our short allocation and go long as our strategy guides us.

### Long Term

While we believe the bear market will last for years and it will take even more years to work off the debt load, we are not perma-bears. We do believe at some point the bear market will be over and it will be time to get bullish. The Cornerstone *Xtreme* portfolio will re-adjust its asset allocation to follow our strategy for a bull market. But this could be several years away.

### Risks

The Cornerstone *Xtreme* will not have risk management as one of its top objectives. It is expected that the portfolio will be very volatile. This volatility should give us trading opportunities.

The primary objective of the Cornerstone *Xtreme* portfolio will be to profit from the current financial crisis. We do not believe the crisis will end quickly, but should last for years. At the point at which our research indicates the financial crisis and its aftermath are over, we will re-assess our primary objective and determine what is most appropriate at that point. It may be a bull market in stocks and bonds.

If this is the type of proactive money management you would like, please contact Cornerstone and we will send you a copy of our Form ADV which contains an explanation of all fees and charges.

## Strategy

- ◆ Index and Sector bear market ETFs and Funds and options to take advantage of the long term bear market
- ◆ Gold to take advantage of the falling Dollar
- ◆ S/T Treasuries to profit from declines in S/T rates
- ◆ Trading positions to take advantage of bear market rallies
- ◆ Asset allocation will shift as the markets and our strategies shift

**Questions, comments, further information, to set up an appointment or request forms, call: Toll Free:**

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**Cornerstone  
Investment**

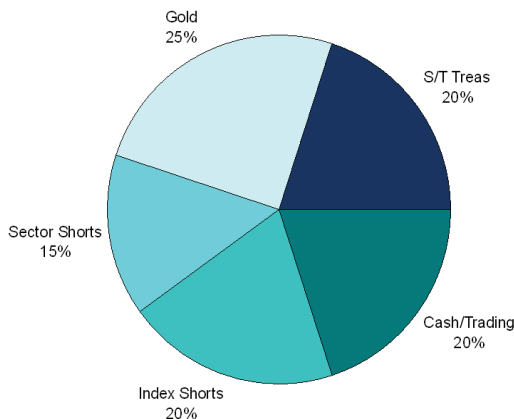
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## Sample Asset Allocation



This is a sample of an asset allocation we could utilize. Your asset allocation will be different as the allocation will continually change as the markets and our strategies change.

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