CORNERSTONE
INVESTMENT SERVICES, LLC

Cornerstone Commentary

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Welcome to the Briar Patch!

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Skyrocketing oil prices, real estate collapse, stock market dropping like a stone, possible bank failures, billions in write-offs, recession, political turmoil, terrorism, and war. What a great investment environment!

This is my world. Welcome to the Briar Patch!

Very little surprises us at Cornerstone. We expected many of the current headlines. We even expect things to get worse before they get better. And here's the secret – Your portfolio with Cornerstone is set up to take advantage of many of today's and tomorrow's problems. Let me explain how.

The things that worry you, they worry us too. But today, as never before, there are investment vehicles available to profit from negative news and a bad economy.
Here's a recap of some of the major concerns:

Concerned about the stock market?

So are we. We think the stock market will probably drop another 50% or more, before all is said and done. So we have bought funds and investments that hedge the downside through various strategies and will actually profit from stock market declines. So while everybody else is moaning about the market collapse as they watch their index funds, growth stocks and blue chips lose more and more money, you can be comforted knowing you have part of your portfolio designed to profit from the market's decline.

Rising oil prices have got to be bad, right?

Rising oil prices will impact a myriad of industries, directly and indirectly, causing inflation to get worse, much worse than what the government numbers show, in our opinion. The simple cure is to own a variety of oil companies. We own oil services, refiners and explorers. So as oil prices rise, and the oil company's profits rise, the investor benefits.

But rising oil prices are also a fundamental cause of higher inflation. And it impacts a wide variety of products. So we also invest in other areas that traditionally have risen when inflation rises. These include natural resources, hard assets and commodities. So when you go to the grocery store and see higher prices for tomatoes, corn flakes and steak, you can smile a little knowing you probably own a basket of agricultural commodities.

How does the Real Estate collapse impact me?

Real estate saved the economy for a few years. Consumers used their homes as ATMs, pulling money out of their home equity, fueling the economy. But with lower housing prices and higher lending standards, the real estate ATM is virtually closed, leaving the economy looking for another source of spending money. This will help push the economy deeper into recession, and prolong its depth and length. Stocks will likely have a hard time of it as the economy struggles.

But a declining stock market is what we are expecting and investing to profit from, so other than your own house being worth less, the real estate collapse shouldn't impact your investments too negatively.

Highlights

- **Real Estate ATM Closed**
- **Collapsing Dollar**
- **Bank Failures**
- **Rising Commodity Prices**
- **Bear Market for Stocks**

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**

Highlights

- **Throwing Money At the Banks Won't Solve the Problem**
- **You Don't Want to Be The Next President**
- **Hedges counter the "unpredictables"**

I'm hearing about brokerages and banks needing billions of dollars because of write-offs of bad investments, mostly sub-prime mortgages. How does this affect me?

This is a complex issue that will not be resolved for years. So far, the solution is to throw more money at the problems. This is not the solution. It is simply a way to keep these banks and brokerages from failing. Bottom line, they made bad investments and they should accept the consequences. If you made a bad loan to your good-for-nothing Brother-In-Law, do you think the government would be coming to your aid, paying off the loan for him? I don't think so.

Simply put, the bail-outs and cash infusions are temporary fixes. The long term impact will likely be tighter credit standards and harder to get loans. This will impact the economy by reducing the liquidity needed to keep it going. Add this as one more reason we are negative on the long term prospects for the stock market. And one more reason we own the market hedges.

How will the election affect things?

Regardless of whoever you are rooting for, they don't stand a chance of fixing what ails the economy. The next President is going to get the equivalent of a flaming bag of economic poo. No matter what he (or she) does, they are going to get #$%@ all over them.

Getting the economy off its addiction to debt will be as much fun as a junkie kicking heroin. There is no pretty way to do it. It will include a recession, higher interest rates and a much lower stock market. And it may take years to bottom out, not just a few months. There is no quick fix available.

That doesn't mean the Government won't try and that Wall Street won't hail whatever comes down the pike as the greatest economic plan ever, but unless it somehow makes debt evaporate and at the same time miraculously keeps investors whole, it will be nothing but a quick-fix, with no long term economic benefits.

What this means though is that there will likely be some rallies in the stock market that can be traded. Bear markets don't drop straight down, and economic stimulus plans are a good excuse to rally. Our cash positions are poised to take advantage of trades as they become available.

Terrorism and war are unpredictable, this makes investing too risky, doesn't it?

Yes it does. Investing in the stock market becomes much riskier. But, as we said before, we own hedges on the market. They will benefit from any market declines. First, let's clarify what we believe. There will be more acts of terrorism and there will be more wars, maybe even in new places like South America. The economic impact of terrorism is usually short term, while the effects of war can be longer term, depending on where and who is involved.

While we don't pretend to predict when and where the next act of terrorism will be or when the next hot war will flare-up, we know the impact on investment portfolios are usually the same. Stock market declines, and a rush to safe investments like gold and treasuries. By owning the appropriate investments ahead of time, we are already prepared for whatever happens.

I know the Dollar is falling, but what does it mean to me?

The Dollar's collapse is a result of the Fed's decade long easy money policies. The Federal Reserve has been keeping the money supply "loose" which means it is easy to borrow money and also puts a lot of Dollars in circulation. The more Dollars are floating around the world, the less valuable those Dollars are.

Also, foreign investors have been buying US bonds. These bonds have a maturity value, in US Dollars. The declining value of the Dollar makes these bonds worth less in the foreign investor's home currency. Think of it like this: You loan $1,000 to a friend. When the loan comes due, he tells you things are tough for him and he can only pay you back $990. You give him a week and he says he can now only pay $980. After another week of waiting, all you can get is $950 for your $1,000 loan. At some point, you give up and take what you can get.

This is the fear of many Dollar watchers - that foreign bond holders will give up and start dumping US bonds to get what they can before the Dollar completely collapses.

Highlights

- Paul Volcker is not at the Fed anymore
- Fed's actions are hurting the Dollar
- Gold Hedges the Dollar
- Previous Bear Markets took decades to break even

The result – much higher interest rates in the US. Mortgage rates through the roof. Any hope for a real estate recovery are gone. Forget about economic recovery. Hyper-inflation will likely be the result of a Dollar collapse.

Can the Fed prevent this scenario? Yes, by raising rates on the short end now. Raising short term rates will protect the Dollar, and tighten the money supply, curtailing lending. Of course, this will also kill the US economy. The recession we are heading into would likely get much worse. Have no fear, the jellyfish at the Fed are more concerned with popular opinion than doing what is right.

The last time we had a Fed Chairman with the foresight and intestinal fortitude to make a move as controversial as this was Paul Volcker back in the early 80's. Volcker was hated at the time he made such bold moves. Today he is revered as one of the toughest and smartest Fed Chairmen.

So how do we profit from a falling Dollar? Gold is the first best hedge on the Dollar. As the dollar declines, gold goes up in value because it is viewed as a store of real value, while paper currencies lose value. The next strategy is simple, if the Dollar is falling then other currencies are rising. So we invest in foreign bonds and equities. They can benefit from the falling Dollar.

Why can't I just own a bunch of Index funds and Blue Chip stocks? I'm told they always come back, so I shouldn't worry.

This is true. They do come back, eventually. But are you really willing to wait that long? The most recent bull markets in the US took quite some time to recover. It took 25 years to break-even from to top of one bull market, and 16 years to break-even from the top of the second. In Japan, they are still down about 75% from their market's high. When was that high? 19 years ago.

When will "It" happen?

"It" is probably happening right now. "It" is the market topping out and the economy heading lower. Investors and strategists like to single out one event or a single date as the point in time the markets and economy changed direction. They like to be able to say that the market will top out at "such and such" and it will decline to "…something else." That's not how it works. Market tops can be long drawn out affairs with the peak only obvious well after it has happened. The seeds of the top in both the economy and stock market are planted well in advance of the top and are not obvious to most investors.

If someone pushed us, we would have to say the Dollar is the key to everything. It's decline should trigger higher interest rates, push inflation higher, kill any hope of a real estate recovery, cause an economic slowdown to get even worse, and contribute to lower stock prices.

Any rally in the Dollar should be short lived and give an opportunity to rebalance portfolios. The only way the Dollar can see any real strength would be if the Fed were to raise interest rates and debt levels were to decline. Both of these scenarios would be bad for the economy and the stock market in the short run,(a few years), but actually lead to a healthier recovery in the future. The odds of this happening? Slim and none. There is no Paul Volcker at the Fed these days.

What should we do?

The current environment and the future problems require a strategy that is pro-active and flexible. Buy and hold just won't work. Running and hiding in CDs or T-Bills won't work either. Luckily, there are many unique and sophisticated investments available today that an investment professional can utilize within a portfolio to lower the overall risk and still be able to give good returns to the client. Unfortunately, too many money managers are still doing things the old way, and not taking advantage of the opportunities we at Cornerstone are seeing.

For us at Cornerstone, we are going to keep working on how to take advantage of the problems that surround us. We are going to keep searching for ways to profit from the negative headlines. So far, nothing much has surprised us, we've expected just about everything that is going on. High oil prices, rising inflation, geo-political tensions, declining stock market and a collapsing Dollar, just another day in the Briar Patch for Cornerstone!

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