

## The Tonge Telegraph

### October 2007

#### Autumn Thoughts

Leaves swirl about, and so traditionally do events in the financial markets at this time of year. It's a big help that some positive movement started in mid-to-late August. What's more, the sub-prime problem forced the Federal Reserve's hand regarding a rate cut, which, like a double espresso, stimulated the system in two ways: it eased the liquidity crisis threatening the economy; and it signaled the Fed's willingness to act decisively even though the action might be at odds with its long-term program.

Fed chairman Bernanke is an anti-inflation guy. His target is 1-2%. We have been at the upper end of that range for a while, so the last thing he really wants to do is lower interest rates, thereby increasing inflationary pressures. The short-term fix of a rate reduction was necessary but it does not address the longer-term problem. Alan Greenspan's new book also expresses a concern about inflation over the next 20 years. I believe we can expect this to be the limelight issue for a considerable period to come.

If I thought I knew how to solve that long-term problem, I'd probably be hallucinating. I do know the short-term problems have to be dealt with effectively so that there can be a long term. The guys at the Fed—in a more focused way than the rest of the Washington crowd—are looking out for our best interests. Rich or poor, large company or small, we are all part of the gears in this economy, and the Fed's job is to keep the machine running. My assessment: for the most part, they're pretty darn good at it.

Portfolio changes: In the past month, I've made extensive use of Exchange Traded Funds (ETF's). ETF's—think of them as baskets of stocks, each representing a different sector of the market—are just possibly the best thing Wall Street has created for the individual investor in the last 25 years. They cost less to operate than traditional mutual funds, provide the same diversification, and have the added advantage of always holding exactly the securities you expected to own when you bought them. The stocks in each basket are fixed regardless of whether the market is up or down.

The great benefit for me is that I can invest with all the advantages of individual stock ownership while eliminating the risk connected to a single company. For example, if I want to own something in the oil sector, I might buy Exxon Mobil, the most profitable company, or I could instead buy the Energy ETF. If I own Exxon alone, I bear the risk that something like the Exxon Valdez accident happens and the stock takes a hit. If I buy the Energy ETF, I get 20 large oil companies, spreading the risk while still owning Exxon (24% of the ETF) and the sector. Some newer ETFs replicate the S&P 500 in, say, Brazil or Sweden or China. I can buy countries or regions with greater control than ever before, a mode of investing once available only to large institutions.

So many brilliant colors to appreciate in this very active season!