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## STAGFLATION: Been there...done that



The term "stagflation" was first used in 1965 and is attributed to British Conservative Prime Minister and later Chancellor of the Exchequer *Iain Macleod*, who used it in a speech to the UK Parliament to explain the troubled economy of Great Britain during the 1960's.

Basically it is the result of an economic slow down accompanied with inflation.

In the 1970's the US began its own path towards a "stagflationary" process. The high oil prices that resulted from the OPEC oil embargo in 1973 (price per barrel quadrupled to \$12), and the price controls imposed by the Nixon administration created not only high inflation (13.5%), but also an impressive level of unemployment (11%) due to lower demand of goods and services thus creating a slowdown in economic output. At that time, the average interest rate of a 30-year mortgage was 18.45%.

In order to attack the crisis, Mr. Paul Volcker then Chairman of the Federal Reserve, made some bold moves. Based on the assumption that Inflation was a "psychological battle" (if people think inflation is to continue, they will rather spend their money than see it loose value making consumers drive prices and demand higher wages), Mr. Volcker had to convince Americans that the matter was under control. And in order to do so he began raising interest rates, pushing the Fed Funds Rate to 11% making banks adjust their prime rate to 13%. This helped to reduce money in circulation since most people would start saving rather than spending and it, and also helped to strengthen the US against foreign currencies. The key concept behind Mr. Volcker's decisions was to control money supply: An adequate supply of money in circulation would keep interest rates moderate and also inflation in control (if you have enough in your pocket, you spend some and you save some).

In theory the situation is similar today than what is was back in the 70's. Inflation is at 4%, unemployment for the year was 5.5% and 30-year mortgages are at 6.25%. However as these numbers point out, the economy is much better today than what it was 30 years ago.

Moreover, the US economy is immersed in a wider "globalization", where the speed and amount of information allows policy makers to act fast. Add to this the fact that the current Chairman of the US Federal Reserve, Mr. Bern Bernanke is an expert on the subject; his Doctoral Thesis is titled "Long Term Commitments, Dynamic Optimization and the Business Cycle", make him a great candidate for taking the necessary actions to boost the US Economy.

Therefore, do not be surprised if the Federal Open Market Committee soon begins to increase interest rates as a measure to slow down inflation.



Mr. Paul Volcker, Chairman of the US Federal Reserve from 1979 to 1987

However here again is the psychological factor that must be overcome.

Unlike back in the 70's, it is Investors that are now bombarded and overcome with fear, justifiably so. The subprime crisis and the surge in the price of Oil have had a major impact on the financial system and, thus, on Wall Street. But while we still have a way to recuperate from the trauma (and the financial losses), it is safe to say that the US economy today is in a much better place than it was back in the 70's. As Mr. Bernanke said on the eve of Milton Friedman's 90th birthday (November 08, 2002): "Let me end my talk by abusing slightly my status as an official representative of the Federal Reserve System. I would like to say to Milton and Anna: Regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again." Thanks to Milton Friedman and Paul Volcker, Mr. Bernanke has a very good idea of what needs to be done in order to get us out of a stagflation in a relative short time.

Andrew H. Jacobus

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### Market brief:

U.S. Treasury Secretary Henry Paulson said the nation's four biggest banks were ready to kick-start a market for covered bonds that could help significantly expand home mortgage financing.

"I believe covered bonds have the potential to increase mortgage financing, improve underwriting standards and strengthen U.S. financial institutions by providing a new funding source," Paulson said at a press conference on Monday.

Covered bonds, issued by banks and secured by pools of assets like home loans, are widely used in Europe but have only become attractive in the United States since the segment of the mortgage securitization market driven by investment banks dried up last year amid a wave of foreclosures.

## The World is NOT coming to an end !



Do not panic, keep your perspective on the long term

**Wealth is having the freedom to do what you want. Having massive amounts of debt hanging over your head is not wealth, it is a financial albatross that will take your freedom away.**



Warren Buffett

Yes, we realize that the stock market has taken a few on the chin and that the year-to-date picture is certainly negative (S&P down 15.6%, DOW down 16.3% and the NSDAQ is down 15.6%). But one must not panic. If we look at various sectors, figures show that for the first half of 2008, earnings for the Financial groups have fallen 85%, and the Consumer Discretionary sector has fallen 21%. But the rest of the sectors that compose the S&P Index have shown average weighted returns of 23%. Specially companies that export goods and services have benefited from a weak

Dollar and their sales overseas. Also sectors like Health Care, Materials and Consumer Staples have shown positive result for the first half of 2008.

Earnings reports from institutions like JP Morgan, Citigroup and Morgan Stanley where better than expected, indicating that most of the write-offs due to the subprime mortgage crisis are probably behind us.

As for the FANNIE MANE (Federal National Mortgage Association), and the FREDDIE MAC (Federal home Loan Mortgage Corporation), while these government

sponsored enterprises (GSEs) still face risk, they are to big to fail and we are confident that government will directly assist these entities. After all we are in an election year.

Overall, bad news seems to be fading away and a brighter picture appears to be on the horizon. The second half of 2008 and then 2009 should be a much better time for the equity market.

Patient and careful selection of investment opportunities will prove beneficial to your financial situation. After all, it appears the world will not end soon.

## Warren Buffet: Good advise from the "Oracle of Omaha"

As these are rough times for stock investors, it is worth looking into how the richest man on earth became most successful investor of our time. The following are his best quotes of all time on being a sensible investor.

1. Rule No.1: Never lose money. Rule No.2: Never forget rule No. 1.
2. Investing is laying out money now to get more money back in the future.
3. Never invest in a business you cannot understand.
4. I don't look to jump over 7-foot bars: I look around for 1-foot bars that I can step over.
5. I put heavy weight on certainty. It's not risky to buy securities at a fraction of

what they're worth.

6. If a business does well, the stock eventually follows.
7. It's far better to buy a wonderful company at a fair price than a fair company at a wonderful price.
8. Time is the friend of the wonderful company, the enemy of the mediocre.
9. For some reason people take their cues from price action rather than from values. Price is what you pay. Value is what you get.
10. In the short run, the market is a voting machine. In the long run, it's a weighing machine.
11. The most common cause of low prices is pessimism. We want to do business in such an environment, not

because we like pessimism, but because we like the prices it produces. It's optimism that is the enemy of the rational buyer. None of this means, however, that a business or stock is an intelligent purchase simply because it is unpopular; a contrarian approach is just as foolish as a follow-the-crowd strategy. What's required is thinking rather than polling.

12. Risk comes from not knowing what you're doing.
13. It is better to be approximately right than precisely wrong.
14. All there is to investing is picking good stocks at good times and staying with them as long as they remain good companies.
15. Wide diversification is

## Warren Buffet—Continuation

only required when investors do not understand what they are doing.

16. You do things when the opportunities come along. I have had periods in my life when I have had a bundle of ideas come along, and I've had long dry spells. If I get an idea next week, I'll do something. If not, I won't do a damn thing.

17. [On the dot-com bubble:]

What we learn from history is that people don't learn from history.

18. You are neither right nor wrong because the crowd disagrees with you. You are right because your data and reasoning are right.

19. You don't need to be a rocket scientist. Investing is not a game where the guy with the 160 IQ beats the guy with 130 IQ.

20. You should invest in a business that even a fool can run, because someday a fool will.

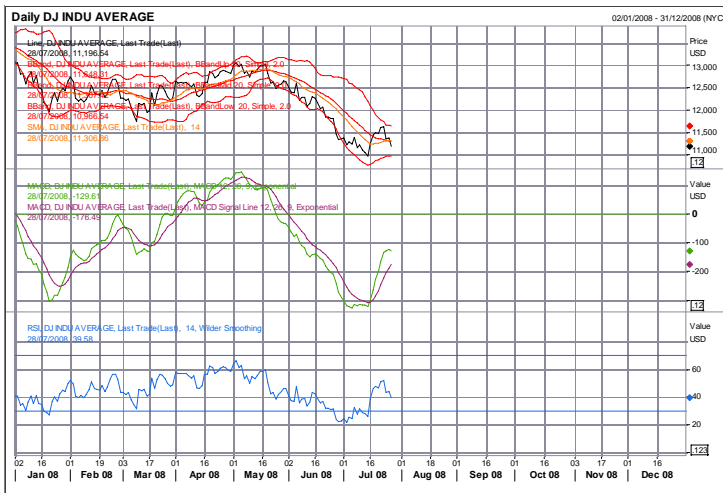
21. When a management with a reputation for brilliance

tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.

22. The best business returns are usually achieved by companies that are doing something quite similar today to what they were doing five or ten years ago.

23. Diversification may preserve wealth, but concentration builds wealth.

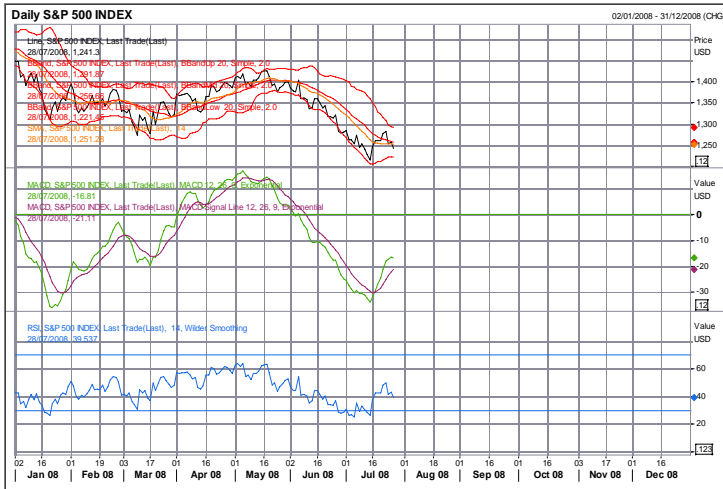
## The Dow Jones and S&P 500 Technical Analysis



### DOW Jones Industrial Average Index

- Current level is hovering the 200 day MOVING AVERAGE (Orange line);
- The Moving Average Convergence Divergence MACD lines have crossed in and upward trend. However the green line (slow average) is about to cross the Fast average (purple line) downwards;
- The Relative Strength Index (RSI) is loosing momentum.

Implies market is due for further downward correction in the near future, and then stabilizing around the 11,500 mark (currently at 11,183).



### S&P 500 Index

- Is following the same statistical path as the Dow Jones Industrial Average.

Should stabilize around the 1,270 mark (currently at 1,240)

## Our Interes rates

## AUGUST 2008

TYPE AND LENGHT OF INVESTMENT	AMOUNTS ARE IN US DOLARES (\$)							
	5K - 19.999	20K - 49.999	50K - 99.999	100K - 149.999	150K - 299.999	300K - 499.999	500K - 999.999	1M - 2.999.999
INVESTMENT TO MATURITY UNITS A	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD
15 DAYS	0,00%	0,75%	0,75%	0,75%	0,75%	0,75%	0,75%	0,75%
30 DAYS	4,00%	4,50%	4,75%	5,00%	5,25%	5,50%	5,75%	6,00%
90 DAYS	4,50%	5,00%	5,25%	5,50%	5,75%	6,00%	6,25%	6,50%
180 DAYS	4,75%	5,25%	5,50%	5,75%	6,00%	6,25%	6,50%	6,75%
1 YEAR	5,00%	5,50%	5,75%	6,00%	6,25%	6,50%	6,75%	7,00%
2 YEARS	5,25%	5,75%	6,00%	6,25%	6,50%	6,75%	7,00%	7,25%
3 YEARS	5,50%	6,00%	6,25%	6,50%	6,75%	7,00%	7,25%	7,50%
4 YEARS	5,65%	6,25%	6,50%	6,75%	7,00%	7,25%	7,50%	7,75%
5 YEARS	5,75%	6,50%	6,75%	7,00%	7,25%	7,50%	7,75%	8,00%

TYPE AND LENGHT OF INVESTMENT	AMOUNTS ARE IN US DOLARES (\$)							
	5K - 19.999	20K - 49.999	50K - 99.999	100K - 149.999	150K - 299.999	300K - 499.999	500K - 999.999	1M - 2.999.999
FLEXIBLE MANAGEMENT - UNITS B	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD	% YIELD
15 DAYS	0,000%	0,500%	0,500%	0,500%	0,500%	0,500%	0,500%	0,500%
30 DAYS	3,500%	4,000%	4,250%	4,500%	4,750%	5,000%	5,250%	5,500%
90 DAYS	4,000%	4,500%	4,750%	5,000%	5,250%	5,500%	5,750%	6,000%
180 DAYS	4,250%	4,750%	5,000%	5,250%	5,500%	5,750%	6,000%	6,250%
1 YEAR	4,500%	5,000%	5,250%	5,500%	5,750%	6,000%	6,250%	6,500%
2 YEARS	4,750%	5,250%	5,500%	5,750%	6,000%	6,250%	6,500%	6,750%
3 YEARS	5,000%	5,500%	5,750%	6,000%	6,250%	6,500%	6,750%	7,000%
4 YEARS	5,150%	5,750%	6,000%	6,250%	6,500%	6,750%	7,000%	7,250%
5 YEARS	5,250%	6,000%	6,250%	6,500%	6,750%	7,000%	7,250%	7,500%

**NOTES:** FOR BALANCES OF LESS THAN \$5,000; THERE WILL BE A \$25 MANAGEMNET FEE PER MONTH  
 FLEXIBLE MANAGEMENT INVESTMENTS - UNITS "B" HAVE A \$10 PER MONTH FEE  
 THE INVESTMENTS TO MATURITY - UNITS "A" ARE FREE FROM FEES

**INVESTMENT TO MATURITY - UNITS A:** YOU CANNOT WITHDRAWAL FUNDS UNTIL MATURITY

**FLEXIBLE MANAGEMENT - UNITS B:** YOU MAY WITHDRAW MONEY DURING THE INVESTMENT PERIOD

**UNDERLYING ASSETS:** SHORT TERM CERTIFICATES OF DEPOSIT. AAA PREFFERED STOCK  
 EMERGING MARKET BONDS AND SHORT TERM FINANCIAL OPTIONS

**MANAGEMENT ENTITY:** Serfincorp Asset Management, Florida (USA) together with Corfiser International Finance, The Netherlands and Serfincorp Finance (Scotland) CV, Edinburgh, Scotland.

**CUSTODY ENTITY:** Smith Barney, New York (USA)

**CLASIFICATION OF INVESTMENT:** CONSERVATIVE RISK - MODERATE YIELD

**MINIMUM AMOUNT OF INVESTMENT:** US \$ 5,000.00 (FIVE THOUSAND DOLLARS)



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