



“We’re Not Out of the Woods Yet”

With the barrage of economic information hitting the newswires these days, most of us want just one simple question asked: Is it getting better or worse out there?

The good news is that the economy is not imploding. For now, at least, it appears that the United States and Europe will muddle along without a major default or crisis event. Congress and the White House have agreed to play nice for the time being, and it looks like Spain and Italy will avoid having to go to the European Union hat-in-hand for a bailout (or at least not right now).

But while the sky may not be falling just yet, that doesn’t mean that it is sunny. The economy is still very weak, and improvement—when it comes at all—is painfully slow. Take a look at some of these recent headlines:

“U.S. Mortgage Applications Tumbled Last Week” *Reuters*, August 31, 2011

“U.S. Job Growth Slowed in August for the Second Month in a Row” *Reuters*, August 31, 2011

“New-Home Sales Fall; 2011 Could Be Worst Year Yet” *Associated Press*, August 23, 2011

“U.S. Unemployment Remains Disturbingly High” *Wall Street Journal*, August 30, 2011

Yes, dear investor, we have two recurring and interrelated themes. Americans are out of work in the highest numbers in decades, and the housing market—which did so much to fuel the economic boom of the mid-2000s—appears to be stuck in terminal decline. The housing crisis has gotten so bad that the White House recently proposed converting 250,000 foreclosed properties held by government controlled Fannie Mae and Freddie Mac into rentals, with Uncle Sam playing the part of landlord.

While it has become fashionable to bash any and all government responses to the crisis, there might actually be some merit to this proposal. Sure, the government is unlikely to be any more effective as a landlord than it is in its other endeavors. The properties turned into rentals could easily fall into decay like most of the country’s government-funded welfare housing.

Even so, as unappealing as this might be, it is still probably better than flooding a weak market with a massive number of foreclosures that will immediately push down prices further. Falling home prices put more Americans underwater on their mortgages and encourage them to simply walk away. Better to have a renter living next door to you in a government-owned house than to have it be vacant and derelict.

As investors, we are presented with similar issues. There aren’t a lot of “good” options for investment out there, but there are plenty that “aren’t that bad.” It’s not realistic to expect 15-20% returns from buying and holding the average mutual fund. But we can still generate modest but respectable returns by taking a careful, tactical approach to investing and by focusing on income.

We will get through this rough patch. It will take time, but America's economy will eventually get its legs back and will run again. In the meantime, we will continue to seize opportunities as we see them.

Sincerely,

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