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# CAPITAL INVESTMENT MANAGEMENT

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*Registered Investment Advisor*

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## Third Quarter Newsletter

October 1, 2007

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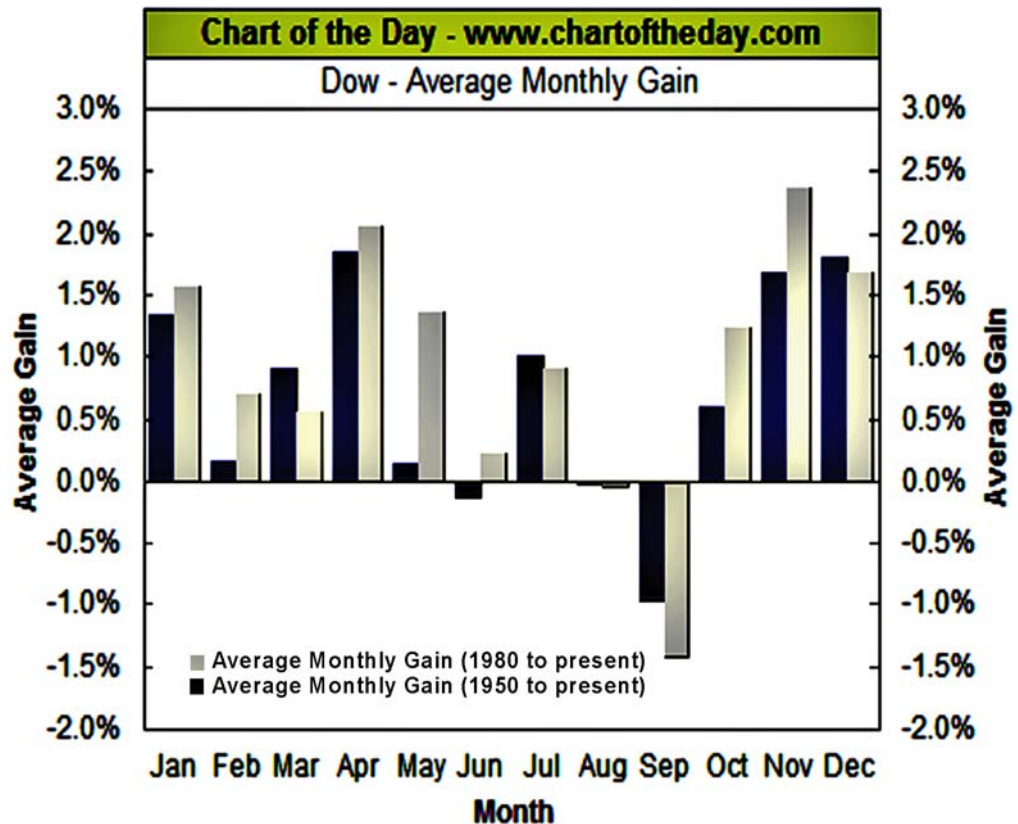
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## October through April Historically the Best Time to Invest

*"strong half of the year...has historically been the end of October through the end of April."*

The strong half of the year for the stock market has historically been the end of October through the end of April. The vast majority of the gains in the S&P 500 and Dow Jones Industrials\* have been made in this period since 1950. While this pattern doesn't always play out - notable exceptions were 1973-1974 and 2000-2001 - and past performance is not a predictor of future returns, the trend gives us hope for a strong close to what has been one of the more volatile years on record.



\* Past performance is no guarantee of future results. The S&P 500 and DJI are indexes and as such cannot be invested in directly.

## Is Buy-And-Hold Really the Answer to Successful Investing?

“Before you take the buy-and-hold argument to heart, look at the assumptions of the study and ask yourself if they ring true for your situation.”

Market downturns inevitably seem to lead to a resurgence of articles supporting buy-and-hold investing, complete with back tested studies of fictional investors proving that trying to “time” the market doesn’t work. But before you opt for a passive approach to your investments, take another look at the studies and ask these questions:

### ***What is the length of the study?***

Most studies supporting buy-and-hold investing use periods of 20 years or greater. Given the market’s historical upward bias, over longer time periods, the impact of down markets is reduced.

Investors who are looking at a shorter investment span, where they will need to withdraw assets not in 20 years, but in 5 or 10 years, or perhaps are withdrawing funds now, could face a very different scenario. Based on historical data, it takes 3-8 years to recover from a bear market. If you need your money during that time it doesn’t matter that the long term trend is up.

### ***Do the studies look at the value of missing down markets?***

There’s two sides to taking a more active approach to investing. One is obviously to be invested when the market is going up. The flip side is to move out of vulnerable investments when a downtrend appears to be

taking shape.

This is risk management at its most basic. Many studies supporting buy-and-hold investing are full of the risk of missing up days, but light on the value of preserving capital when the market drops.

### ***Are the assumptions reasonable?***

One of the statistically “impossible” arguments against active management is the impact on performance of missing the best days or months of the time period. Whenever you encounter this argument, you can be virtually sure the flip side – which is also statistically impossible – missing just the worst days or months – is omitted.

Before you take the buy-and-hold argument to heart, look at the assumptions of the study and ask yourself if they ring true for your situation.

### ***If mention is made of moving in and out of the market in response to market trends, what are the criteria used for moving out and back into equities?***

Good active management is based on carefully developed and back tested principles of market behavior. The investment manager looks for relationships and trends that reoccur over time and indicate a likelihood that the market will move in a

similar fashion this time. Emotions and media coverage have no place in the criteria.

### ***Do you have the temperament to endure sustained losses?***

Buy-and-hold investing can work for investors over longer time periods. But it goes counter to human nature. Studies supporting buy-and-hold investing typically deal with smaller account values. If an account of \$10,000 loses 25% of its value, i.e. \$2,500, it doesn’t sound so bad. If your \$500,000 account loses \$125,000, it sounds a lot more like real money. Which is why few investors truly buy and hold. When the pain gets too great, they sell. And, without a plan to reenter equities, they lose opportunity when the markets recover.

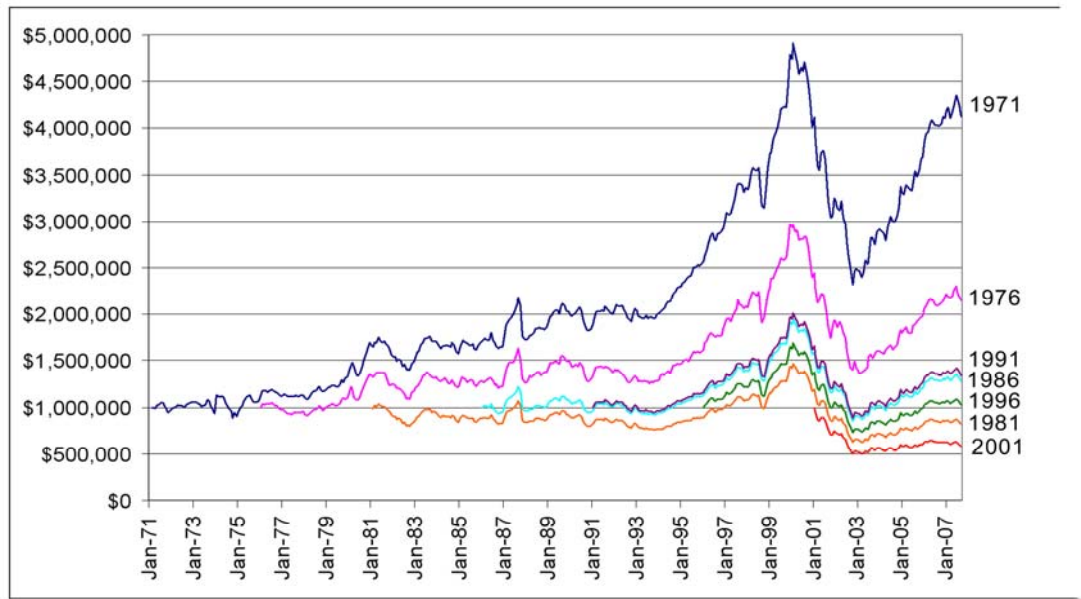
Investing is a risky way to make money. It only makes sense to look at ways you can control some of those risks. Looking back at market history and saying....well, the market has always recovered so it will this time as well... is taking a lot for granted. With each market decline, the circumstances change. Different investments tend to move to the forefront, risk return ratios shift.

Our goal in managing client assets is to always take a thinking approach to where you should be invested and why. We believe buy-and-hold investing is far too risky for most portfolios and we welcome the opportunity to show you why. (Con’t)

## Is Buy-And-Hold Really the Answer to Successful Investing? (Con'd)

“Our goal in managing client assets is to always take a thinking approach to where you should be invested and why.”

Performance of a Hypothetical Fixed Asset Allocation Portfolio  
Over Seven Time Periods



The preceding example looks at the performance - based on seven time periods - of a hypothetical fixed asset allocation portfolio from which the investor withdraws \$5,000 each month. The portfolio begins with \$1 million and is rebalanced at the start of each year to maintain the following allocation:

- 40% S&P 500
- 30% 10-Year Treasury Notes
- 20% Nasdaq
- 10% 13-Week Treasury Bills.

By using an asset allocation approach, losses are moderated during market downturns, but not eliminated. The time period that an asset allocation strategy is in place has a significant impact on its long-term performance. An early loss can significantly blunt the future growth potential of the portfolio as the portfolio which begins in 1981 demonstrates.

*Data from Yahoo Finance, adjusted for dividends and splits. All data is based on published indexes including the S&P 500, Nasdaq, IRIX and TNX, adjusted for dividends and splits. Investors cannot invest directly in these indexes. No consideration is made of the impact of trading costs, inflation or taxes on the hypothetical portfolio. Past performance is not indicative of future returns.*

## Make Annual Credit Reports a Priority

*"A good credit report is essential for getting good financing rates, insurance rates and even a good job."*

Did you know that the more money you have and the better your credit, the more you are a target for identity theft? It's a bit like Willie Sutton's old quote about why he always robbed banks. "Because that's where the money is."

A good credit report is essential for getting good financing rates, insurance rates (insurance companies claim that there is a direct relationship between a consumer's payment history and the number of loss claims they file) and even a good job. The growing opportunities for identity theft also make checking your credit report a priority. The first place identity theft often shows up in a credit report. Knowing what is on your credit report and getting errors corrected promptly is your best defense against bad credit scoring and identity theft.

Aside from identity theft issues, according to a study released by the National Association of State PIRGs, almost 80% of credit reports contain either serious errors or other mistakes of some kind. These errors can result in the appearance that the consumer has "too much" credit available, is overextended or is not a responsible payer.

In 2005, the Fair and Accurate Credit Transactions Act (FACT Act), took effect, enabling consumers -- by contacting a single number, Web site or address -- to request their credit reports from the three

credit bureaus at no charge once a year. I encourage you to order your free report now if you have not done so this year and to make a habit of doing so annually.

You can order your free annual credit report online at [www.annualcreditreport.com](http://www.annualcreditreport.com), by calling 877-322-8228, or by completing the Annual Credit Report Request Form (available on line at [www.annualcreditreport.com](http://www.annualcreditreport.com)) and mailing it to: Annual Credit Report Request Service, P.O. Box 105281, Atlanta, GA 30348-5281.

[www.annualcreditreport.com](http://www.annualcreditreport.com) is the only authorized source for your free annual credit report from the three nationwide consumer reporting companies, so don't fall for marketing pitches from other organizations offering to provide you with a free credit report. Those offers typically come with strings attached. When you contact the site, request credit reports from all three of the major credit bureaus -- TransUnion, Experian and Equifax.

If there are any inaccuracies on your report, talk with a representative of the credit bureau immediately and find out what needs to be done to correct the information. But don't stop there. If you suspect identity theft, request that the consumer credit reporting companies place "fraud alerts" in your file to let potential creditors and others know that you may be a victim of identity theft. A fraud alert can make it more

difficult for someone to get credit in your name because it tells creditors to follow certain procedures to protect you. It also may delay your ability to obtain credit. File an identity theft report with your local police at once. Notify any creditors you don't recognize that there is a problem with the account.

Under federal law, you are also entitled to a free report if you are denied an application for credit, insurance, or employment. You must ask for the report within 60 days of receiving notice of the action. You're also entitled to one free report a year if you're unemployed and plan to look for a job within 60 days; if you're on welfare; or if your report is inaccurate because of fraud, including identity theft. Otherwise, a consumer reporting company may charge you up to \$9 for another copy of your report within a 12-month period.

For your free annual credit report:

877-322-8228

[www.annualcreditreport.com](http://www.annualcreditreport.com)

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P.O. Box 105281  
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## Two Vital Documents – A Living Will and a Power of Attorney

*“A living will and power of attorney are not giving away control, but rather taking control of your life.”*

The following is a true story related by an associate that points out the importance of planning for the worst. Bad things can happen to good people, but they don't have to be made worse by a failure to plan.

*Two years ago, a good friend suffered a severe stroke that left him with extensive brain damage, dependent on a ventilator and feeding tube to survive. He had lived a long, successful life and accumulated a sizeable retirement portfolio that would leave his wife in comfort for the remainder of her life. After consulting with his doctors, she asked that they discontinue medical treatment and allow her husband to pass away.*

*Then life became difficult. One of the couple's sons sued to force the hospital to continue treatment. My friend had left behind no living will setting limits on how long he wished life-supporting medical treatments to continue. Nor had he established a power of attorney to allow another to make decisions on his behalf*

*should he become incapacitated. Without that level of instruction, there was little the doctors could do. In two years, a significant portion of the comfortable retirement portfolio has been eaten away by medical and legal costs and unprofitable investments that cannot be sold without my friend's authority. The family has been shattered, the wife's serenity destroyed, and my friend still lies unresponsive in a hospital bed.*

Improved medical technologies have brought with them the ability to prolong life, but the decision of whether or not to do so typically rests on the individual once they reach the age of legal consent. When that individual is unable to make decisions and has left no instructions, his or her care can fall into a medical limbo. Regardless of your age, health or family status, you should have a Living Will and a Power of Attorney agreement.

A Living Will is a legal document that sets out guidelines for dealing with life-sustaining medical procedures in the eventuality of the

signor's incapacitation. It can be very general or very specific.

A Power of Attorney is a legal instrument that is used to delegate legal authority to another to make property, financial and other legal decisions for the principal (the individual who executes the instrument). It can give broad or very limited authority and specifies in what circumstances the "agent" is to have this power and when it terminates. The Power of Attorney is frequently used to help in the event of the principal's illness or disability or in legal transactions where the principal cannot be present to sign necessary legal documents.

Most states have statutory forms, i.e. written model forms for Living Wills and Powers of Attorney that residents can rely on as being legal. Depending upon the complexity of your situation, you may want to consult with your legal advisor to develop these forms.

A living will and power of attorney are not giving away control, but rather taking control of your life. Everyone over the age of legal consent should have one.

## 3rd Quarter Market Update

*"Historically, the 4<sup>th</sup> quarter has been positive for the markets."*

There is an old adage on Wall Street that the market climbs a "wall of worry". The wake of the sub prime mortgage fallout that rocked many financial institutions has left a lot of worry drifting about as of late. Largely in response to the sub prime problem, the Federal Reserve felt compelled to reverse its course. Contrary to prior speech patterns that had previously called for a hawkish view on inflation, the Fed performed a surprising cut to the Federal Funds Rate by 50 basis points, reducing the Federal Funds Rate down to 4.75%. The recent cut was double the amount of the 25 basis point reduction that was widely expected. Both domestic and foreign markets appear to have celebrated this move by the Fed by trending higher, but the longer term effects of such action cannot be known and will need to be studied as the markets continue to exhibit wide volatility. One such study will focus on yield curves. Experts often consider the yield curve a leading indicator of current economic status. The yield curve is a line that plots interest rates of bonds having equal credit quality, but differing maturity dates at a set point in time. The three-month, two-year, five year and 30 year U.S. Treasury debt curves are often a focus for such analysis. This curve is often used to predict changes in economic output and growth. The shape of the yield curve is closely scrutinized because many believe it may point to future interest rate changes and offer predictive guidance regarding economic activity as a whole. There are three main types of yield curve shapes: normal, inverted and flat. A normal yield curve is one in which longer maturity bonds have a higher yield compared to short-term bonds due to the risks associated with the amount of time the investment must be held. An inverted yield curve is one in which the shorter-term yields are higher than the longer-term yields, which may suggest there is more risk in the short term and could signal an upcoming recession. A flat yield curve is one in which the shorter and longer-term yields are very close to each other, which is also a predictor of an economic transition. The slope of the yield curve is also seen as important: the greater the slope, the greater the

gap between short and long term rates.

Recently, the yield curve has been inverted and this has captured the Federal Reserves attention. The impact of an inverted yield curve often makes access to short term loans, such as adjustable rate mortgages (ARMs) and lines of credit more expensive. In addition, a yield curve inversion has the greatest impact on fixed income investors because an inverted yield curve eliminates the risk premium often found with longer-term investments allowing the same yield from shorter-term investments. Historically, the odds of a recession increase when the yield curve spread flattens or becomes inverted. However, it is important to note that past recessions only occurred after the yield curve had been inverted for a long time and by a significant amount. Also, the yield curve can invert for other reasons beyond the slowing of economic growth. In response to the Fed's recent 50 basis point cut, there has been a reduction in the amount of inversion and the chart has flattened.

At this point in the economic cycle, it may be that "bad news is good news" for the financial markets. The markets may view any economic weakness as further justification for the Fed's recent bias toward lower interest rates. This more "supportive" position toward the economy reveals the Fed's commitment to prolong, if not revive, the long period of economic expansion we have enjoyed over the last several years. This is likely to influence investor psychology in a positive way. As businesses assimilate the Fed's new, more accommodating policy into their business plans, it may lead to a confidence in the future that only weeks ago did not exist. Historically, this has paved the way to renewed expansion as business views the Fed as an ally, rather than a foe.

Historically, the 4<sup>th</sup> quarter has been positive for the markets. The holiday season typically

starts with Thanksgiving. The retail sales generated the day after Thanksgiving and through Christmas can account for the lion's share of annual sales for some companies. This, combined with budget evaluations by large companies that need to spend their remaining budget this year in preparation for evaluating next year's budget, typically creates solid demand for many different products in the 4<sup>th</sup> quarter of the year. Corporate spending is often allocated to technology and infrastructure to better position companies to attain next year's sales goals. Easy credit is also a catalyst for the 4<sup>th</sup> quarter: even though the credit markets have tightened recently, it now looks like interest rates will subside just in time for the holiday spending season. Many believe that all of these themes suggest that a robust 4<sup>th</sup> quarter may be in store, which could mirror the kind of growth experienced in the last three years when the Dow Jones Industrial Average (DOW) posted returns of 6.71% in 2006, 1.41% in 2005 and 6.97% in 2004.

To be sure, the subprime fallout somewhat hampered third quarter growth, but the Fed's late quarter reduction of interest rates spurred many of the markets sectors to show positive numbers: the Dow Jones Industrials posted a return of 3.63%. The Standard & Poor's 500 Total Return (Inclusive of Dividends) returned 2.03% while the NASDAQ ended with a 3.77% return; the Lehman Aggregate Bond bounced back with a 3.02% for the quarter.\* The IBD Index performed admirably, again, and has shown strength for the last three quarters in a row by posting a return of 4.52%.\*\*

Looking forward to the rest of 2007, the Federal Reserve has shifted its focus from inflation and has recently performed economic stimulating actions including speeches and rate reductions that, may position the 4<sup>th</sup> quarter for growth. China continues to dominate the

## 3<sup>rd</sup> Quarter Market Update (Con't)

*"We believe careful analysis of prices/trend changes, may offer us some insight into the market's prognosis for future prices."*

international landscape and remains the leading position when compared to all other sectors. China may continue to lead well into 2008 considering the Summer Olympic Games will be held there, and they will likely receive the economic benefit of hosting the event. Technology and Utilities have recently shown some strength while international positions in general have outperformed domestic growth funds with the decline of the US dollar compared to the Euro and other world currency.

The investment models we use have been tested this year with two major pull backs in the market and continue to find positions of strength. We believe careful analysis of prices/trend changes, may offer us some insight into the market's prognosis for future prices. It goes without saying that this system, as with any other, is not infallible and does not assure positive results. When

the markets are uncertain about future prices, they tend to stagnate or even decline. While we have made progress this quarter, many investors are just now gaining confidence in the markets due to the day-to-day volatility of the market indices. Models cannot create investment gains in an environment that does not offer sustainable price movement in the securities markets. However, the models will continue to seek investments that are performing well and as new trends emerge the models can allocate assets in those areas. It is important to realize that modeling is not intended to time the markets or trade short-term micro cycles. Rather, this strategy attempts to identify changes in market direction, industry and sector price behavior in an effort to participate in those longer term trends.

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## CIMCO'S INSIDE STORY

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Linda Salmons  
Blossom Ficklin  
Nancy Tagovailoa  
Dee Zimmerman



### FALL FOOTBALL

**Wyoming vs. Air Force**  
**October 20**  
**Noon Game**  
**Tailgate Brunch begins at**  
**9:00 A.M**

**To RSVP call Steve Rice at (303) 577-8248 or**  
**e-mail [srice@cimcodenver.com](mailto:srice@cimcodenver.com)**  
**No later than Wednesday, Oct. 17**

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