Campbell Capital Management

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Dear Money Management Client:

The first quarter easily ranks up there as one of the toughest in history. Panic would best describe the events leading up to the near bankruptcy of Bear Stearns, one of the country's biggest and oldest investment banks. Robert Sobel, a prolific historian of American business wrote that "most panics arise as moments of truth, after periods of self-deception, when players not only suddenly recognize the magnitude of their problems, but are also stunned at their inability to solve them." And that's just where investors found themselves with Bear Stearns. Shocked at the leverage and poor credit quality, fear engulfed trading desks. If not for the Federal Reserve and financial leaders offering billions of dollars in aid, Bear Stearns would have set off a chain of collapse around the world. The 10% decline in stock market averages at quarter's end would have been far worse if the panic had been left to its fruition.

But before we get all alarmist, let's put the current crisis in perspective. As a result of excess and unsound lending, approximately 3.5 million excess homes were built. Home building ran amuck because home prices rose almost 200% in the 20 biggest cities in just 10 years. Easy credit fed the housing boom and higher home prices encouraged easier credit; that's how bubbles are made. Now we deal with the unwelcome unwinding, and if the historical relationship between median home prices and median family incomes has any merit, house prices will fall another 24%. But "perspective" you said! Well, most analysts believe the U.S. housing crisis will cost about 3% to 4% of Gross Domestic Product (GDP) and that just about equals the size of the savings and loan crisis of the early 1990s. Yet the 1990-91 recession was the second-mildest of the postwar era. In Japan's banking crisis, writedowns of non-performing loans amounted to a mammoth 20% of GDP. So the current crisis is bad, but it's certainly manageable.

The current environment is rich with opportunity. Our financial system is the central nervous system of the world and we need it to function properly. As healing occurs and confidence returns, investors will realize that world growth is continuing and quality businesses are on sale. Dividend yields from a well diversified portfolio now match or exceed current bond yields, something that we haven't seen in 50 years. We are optimistic about the future and our ability to share in the success of the companies we own.

We remain committed to a conservative investment philosophy, which emphasizes the preservation of capital. If you have any questions or would like to discuss your portfolio, please do not hesitate to call.

Very truly yours,

Clay Campbell