



THE FOXHALL GLOBAL OUTLOOK



AUGUST 17, 2007

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QUESTION:

Dear Paul,

The stock market has been declining over the past month. At what point will FOXHALL CAPITAL switch to bonds or money markets?

ANSWER:

FOXHALL CAPITAL uses a proprietary system with “stop-loss triggers” to determine when the stock market is entering a major correction or a long-term bear market/recession.

Normally, FOXHALL CAPITAL **does not** sell its positions when there is a simple “pull back” in the stock market or a minor correction. An investor almost always loses money when you try to time the market in pull backs and minor corrections. No one knows how to get out at the top and get back in at the bottom. If the market goes right back up, as it tends to do after most minor corrections, you will usually lose money getting in and out, rather than riding it out.

PAST EXAMPLES: During the summer and early fall of 2004, 2005 and 2006, we had sharp pull backs in the market and then they promptly bounced back reaching record year-end highs.

LAST YEAR MOST EVERYONE WAS WORRIED ABOUT HIGH OIL PRICES

In 2006, the market had a record pull back in July over high oil prices. Television pundits breathlessly predicted high oil prices would plunge the country into recession, unemployment would go up and inflation would soar. Of course, none of this happened and the stock market went up over 14% after the summer pull back. If you had sold out of the market during the summer, you probably lost a great deal of that 14% quick upswing in the market.

WHAT IS A “PULL BACK” OR A “MINOR MARKET CORRECTION?”

Economists consider a stock market “pull back” to be a drop in the market of less than 10% from recent highs. They consider a drop in the market (usually measured by either the DOW or the S&P 500 INDEX) of 10% to 15% a “minor correction” and over 15% to be a “major stock market correction.” In order to qualify for a “bear market” the stock market would have to drop 20%.

As of last night, THURSDAY AUGUST 16, 2007, the DOW was down 8.4% and the S&P 500 INDEX was down 9% from last months record highs.

By any definition, this is still considered a “pull back” and not even a minor stock market correction.

IF THERE IS A MAJOR CORRECTION, FOXHALL CAPITAL WILL GO TO BONDS OR CASH!

For reasons I will explain below, the recent stomach-churning ups and downs in the stock market look worse than they actually are.

But make no mistake, as soon as our FOXHALL CAPITAL “stop-loss triggers” are hit, we will immediately move that portion of our portfolios that have hit their triggers to bonds or money markets.

However, I don’t believe we will hit those “stop-loss triggers.”

THE SUB-PRIME MORTGAGE CRISIS

Feared of U.S. sub-prime loan instability have sparked a rash of panic-selling globally. I know it doesn’t look like it, but this is a very healthy correction that is purging some of the most despicable practices out of the mortgage loan industry and the hedge funds and banks that finance them.

MUCH ADO ABOUT NOTHING

To put all this into perspective, the sub-prime mortgage market makes up less than 20% of all mortgage loans and the number of people who analysts estimate will default on their sub-prime loans is about 10%. That is only

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2% of the overall mortgage loan market. If all of these loans default it would represent a loss of less than 1% of this year's gross domestic product (GDP). This is a much smaller overall impact than the markets experienced during the Savings & Loan crisis in the mid-1980's.

Almost no economist, including those at the Federal Reserve, believes that after the underlying housing collateral is sold at a discount that the final result will have a major impact on the economy.

WHAT WERE THEY THINKING—WHO MADE THESE LOANS?

A lot of these sub-prime loans were made with no money down, 100% to 120% financing, no credit checks and to people without jobs and with no way to repay their loans. Any mortgage company that gave out loans like these deserves to go bankrupt. And the hedge funds who borrowed money to finance these mortgage brokers also deserve to go bankrupt along with the "silly rich people" who invested in these private hedge funds. Also, the banks that lent money to the hedge funds also deserve to sustain losses. These were terrible lending practices and they were destined to end badly. I remember just a few years ago when you had to put up at least 20% of your own money—what a concept—to buy a house!

WHY IS THIS CRISIS CAUSING SUCH VOLATILITY IN THE STOCK MARKET?

A substantial amount of the selling volatility is caused by hedge funds forced to raise money to meet redemptions and to face margin calls. Hedge funds, private investment funds geared to wealthy and institutional investors, use leverage, or borrowed money, to amplify returns. But when their bets go bad, the losses are often huge enough to cause lenders to ask them to back up their loans with more collateral. To raise funds, hedge funds sell whatever they can.

Over the past couple of weeks, these private hedge funds have received "margin calls" from brokerage firms and banks on the loans they took out to finance sub-prime lenders. In order to raise cash fast, they have been dumping billion of dollars of their stock holdings in both U.S. and international stocks.

CREDIT CRUNCH

Some analysts fear that credit will dry up for corporations and people with good credit. The Federal Reserve has been pumping billions of dollars into the banking system to make sure this does not happen. Today, they also lowered their key bank lending rate. The Fed has indicated that it is committed to make sufficient credit available. Yes, people may have to put 20% down to buy a new house, but if they do, they will get a loan.

Jack Malvey, the Chief Fixed Income Strategist at Lehman Brothers said, "When you look at the history of these (credit market) corrections, from 1973 to 2002, we've had about 14 of them, and they tend to burn themselves out over one to three months. This is a clean out of some excesses. It's absolutely therapeutic." FOXHALL CAPITAL agrees.

EXPECT CONTINUED MARKET VOLATILITY THROUGH OCTOBER

Investors hate uncertainty and part of the problem is that until these unregulated hedge funds report their holdings after September 30th, the market will not know precisely the



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extent of the sub-prime exposure to banks and other financial institutions. But we should see fewer big dramatic swings in the market, since most hedge funds have sold off their stock portfolios to meet their margin calls on their loans.

CONCLUSION—OVER THE NEXT FEW MONTHS

The bottom line is; expect more swings in both directions in the stock market through the end of October, when the uncertainty will be eliminated. After that, risks will be thoroughly reassessed and re-priced and the stock market will start focusing on the important trends, like how well the economy and the world economy are doing.

Sam Stovall, the Chief Economist for STANDARD & POORS says the recent sell-off is not enough to push stocks into a bear market. He says it is hard to have a recession when “earnings are still strong, and stocks are trading at 15 times profits vs. 29 at their peak in 2000.”

CONCLUSION—NEXT TWO YEARS

The secret of successful long-term investing is **FOCUS—FOCUS—FOCUS** on the economy. Everything else is irrelevant and will pass quickly. If the economy is strong, the stock market always follows it up. If the economy is deteriorating, that is the only time to completely get out of the market.

WHERE IS THE ECONOMY NOW? Despite this summer sub-prime distraction, the WALL STREET JOURNAL, in an editorial July 31, 2007, said, “The world economy is currently experiencing a level of growth unsurpassed in human history. World growth has been running at close to 5% for over three years—the highest level since the late 1960s. But the current situation is profoundly different from that era: In the 1960s, over two-thirds of the world's people were excluded from the global economy because of their political regimes. During the past 20 years, China, India, the former Soviet Union, Eastern Europe and Africa have rejoined the global economy.

Their re-entry has unleashed a tremendous burst of entrepreneurial energy and set the stage for extraordinary economic growth. China has been growing at double digit rates since 2002. India's growth rate has risen to 9% from only 2%-3% 25 years ago. High oil prices have boosted Russia's growth rate to 6%-7%. The African economy will achieve a growth rate of over 6% this year.”

THE BOTTOM LINE

With the notable exception of the housing industry and the sub-prime loan crisis, all of the fundamentals of both the U.S. and other international economies are very strong, growing and expanding.

At FOXHALL CAPITAL, we believe the stock market will recoup current losses and reach higher levels by the end of the year.

UNTIL NEXT WEEK...

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PORTFOLIO COMMENTARY AND ALLOCATIONS

QUESTION:

“With the level of volatility we have been experiencing, what does the market look like "from the inside"?”

ANSWER:

At Foxhall we continue to believe, based on our research, that we are still in a bull market, i.e. the long term trend is up. That said, we also observe that there are numerous objective indicators that are recording extreme levels of pessimism, fear, and even panic among investors. Each time these levels have been recorded during this long bull market it has been a great buying opportunity as the market has quickly begun a significant rally.

Think about a time that you made a very emotional financial decision, in hindsight do you believe you made the wisest choice and that you got the best price and terms you could have? Did the other party get a particularly good deal because of your emotional state? Similarly there are "smart money" buyers who are waiting for the opportunity to buy at "fire sale" prices from panicked sellers. Our objective measures of extreme selling behavior are indicating that this is the current condition "inside the market". While we certainly understand our representatives' and clients' rising fear level during this volatile period, we are not joining in the panic, rather we are looking for the opportunities for profit this will provide our investors.

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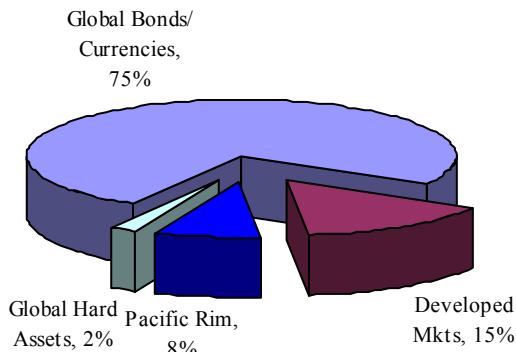




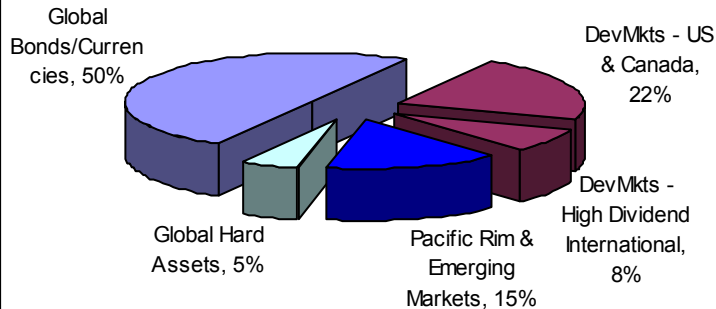
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THE FOXHALL GLOBAL OUTLOOK GLOBAL MARKET ROTATION PORTFOLIOS

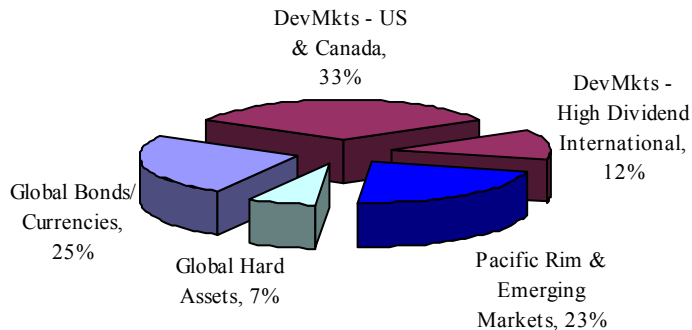
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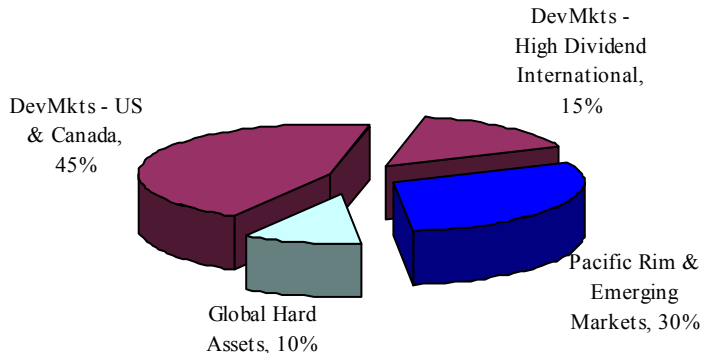
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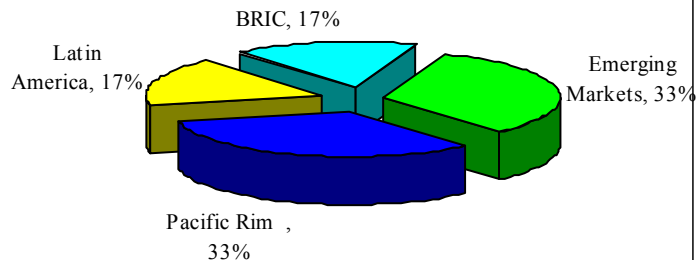
Growth & Income



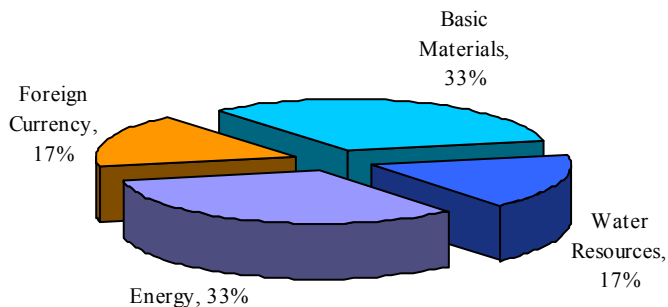
Growth



Pacific Rim & Emerging Markets



Global Hard Assets



The allocations illustrated are model allocations, actual client accounts could vary due to many factors. Variable annuity/variable life accounts will vary significantly due to the availability of investment options in each contract. All allocations may change without notice.