



# Quarterly Memo

January 2008

## Of Special Interest:

- 2007 was a decent year for investors, but what about 2008? 1
- Is the government telling the truth about inflation? 1
- They said it was "MPOF-ible" 3

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## Neither the best nor the worst of times

Depending upon the composition of your portfolio, you may have been very pleased, extremely disappointed, or indifferent with your rate of return for 2007. It was a year of wide return differentials among asset classes. Why was that?

Without a doubt, we will remember 2007 as the year that the housing market collapsed and triggered a credit crunch. The earnings of just about

any company that was involved in homebuilding or lending were crushed. The stock of the average homebuilder dropped over 50% (and over 70% going back to the pre-2007 peak) and financial stocks in general were pummeled. Household names like Fannie Mae, Freddie Mac, Washington Mutual, Countrywide Financial, Citigroup, Merrill Lynch, and Bear Stearns were among the firms caught in the

mortgage market meltdown. As credit tightened and the housing market suffered, investors became more and more worried about the overall economy, triggering stock declines for many consumer goods companies.

On the other hand, spurred by a declining dollar, U.S. exports were booming and reached an

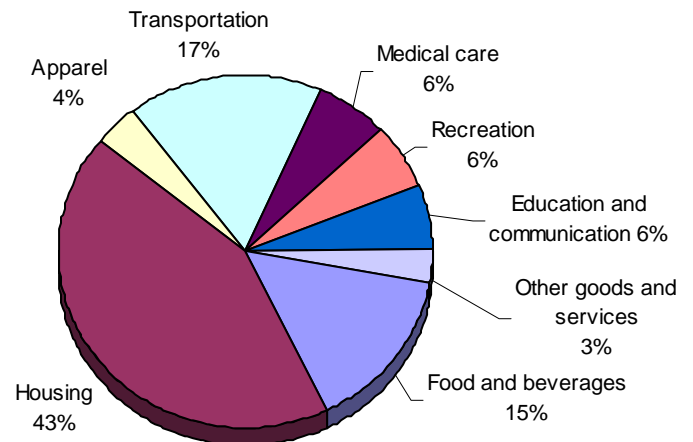
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## Can you trust the Consumer Price Index?

It's a general consensus that the cost of living is going up. But how much? The fact is that inflation in the overall economy is a devilishly difficult statistic to measure. Every month the Bureau of Labor Statistics (BLS) tracks the prices of more than 80,000 goods and services and distills them into one number, the Consumer Price Index (CPI). In December, the November CPI was reported at 210.565 (where the period 1982-84

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**CPI Components**



## Neither the best nor the worst of times (continued from page 1)

all-time high of 12.1% of GDP (as of 9/30/07). Not surprisingly, companies with significant foreign-based earnings did well including (generally) energy, technology, and materials companies.

This resulted in marked performance differences between various US equity indices. Growth stocks outperformed value stocks by 12% or more across all sizes of companies. Small cap value stocks were particularly hard hit, losing almost 10% for the year. Value stocks suffered the most largely due to the large representation of financials stocks in the value indices versus very little in the growth indices. Large and mid-cap companies performed significantly better than small-cap companies. This could be due to the fact that large and mid-cap companies, compared to small cap companies, are more export oriented and more likely to have sales derived from

overseas. It's also noteworthy that relative valuations between growth and value and large and small indicated it was "time" for the long winning streak of small cap and value stocks to reverse. Mid-cap stocks again showed themselves to be an attractive sector of the market.

Overseas stocks also delivered great returns. The most commonly quoted foreign stock index, the MSCI EAFE produced a return of over 11%. The story here is that the falling dollar produced most of the return. In local currency, the index only eked out a 1% return. Also notable is the continuing outperformance of emerging markets stocks, with that index up 36% for the year (30% in local currencies). Related to the overseas story was the continuation of demand for energy and raw materials commodities from China and other high-growth developing

countries. This trend was also reflected in the strong performance of the energy and materials-related sectors in the US.

There was plenty of action in the bond market also. Investors first worried about inflation and then recession. At times they worried about both. The 10-year Treasury yield ranged from a high of 5.25% in June to a low of 3.85% in November and is now at 3.59%. The Lehman Brothers Aggregate Bond Index produced a respectable 6.9% return. The best fixed income returns came from overseas as the dollar's drop gave U.S. investors currency gains that enhanced their returns to over 10%. But outside of the government bond market, perceived credit risk rose, leading to underperformance. The Merrill Lynch High Yield Bond Index return was only 2.2%.

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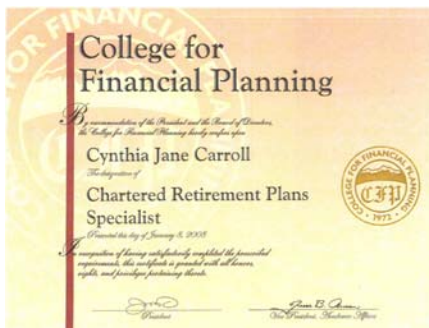
S&P 500 Sector	Foreign Exposure (%)	2007 Return
Energy	54.7%	32.4%
Materials	45.3%	20.0%
Utilities	8.1%	15.8%
Information Technology	54.1%	15.5%
Consumer Staples	41.3%	11.6%
<b>Average</b>	40.7%	19.1%
Industrials	36.8%	9.8%
Telecommunications	3.4%	8.5%
Health Care	36.1%	5.4%
Consumer Discretionary	24.7%	-14.3%
Financials	17.7%	-20.8%
<b>Average</b>	23.7%	-2.3%

## Cindy Carroll Awarded CRPS Designation

Matrix congratulates Cindy Carroll on attaining the designation of Chartered Retirement Plans Specialist (CRPS). The College for Financial Planning grants the CRPS upon completion of an educational program, passing a final examination, and an

ethics commitment. According to Cindy, "This program added to my knowledge of the design, installation, and maintenance of our clients' qualified retirement plans. At Matrix, everyone is encouraged to continually expand our knowledge in

all financial areas. This helps me be a more effective team player with our clients and their plan administrators." Cindy has previously attained the Chartered Mutual Fund Counselor (CMFC) designation and recently celebrated her fifteen year anniversary with Matrix.



## Why Matrix Supports WDAV 89.9 Classical Radio

Every Monday, Wednesday, and Friday at 9:00 AM, Matrix Wealth Advisors sponsors the NPR morning newscast on WDAV classical radio FM 89.9. Why does the firm support this station?

In the early 1980's, Mike McKay was WBT-TV's dapper young weatherman. WDAV was a four year old classical radio station sponsored by Davidson College. With only 20,000 watts and a 350' tower, the signal covered the local area but not much further.

A lot has changed in 25+ years. WDAV is now one

of the premier full-time classical stations in the entire country broadcasting digitally 24/7 with 100,000 watts from its 815' tower and on the internet. Mike McKay moved from the world of television news to his current role of morning announcer on WDAV. It's usually Mike's voice you hear making the Matrix announcement. Since I had not been to the station since the mid-1980's (when CD's were new!) I recently visited the WDAV studios in Davidson to meet the staff, marvel at the new technology, and chat with Mike. One interesting fact I learned is

that Mike also works for the Billy Graham Evangelistic Association's *Hour of Decision* program.

A world-class classical music station is a great asset to this community. Classical music is enjoyed by all, regardless of political persuasion, gender, race, or religion. Matrix is proud to support this vital segment of the Charlotte cultural community that brings listening pleasure to thousands every day in these turbulent times. If you're a listener, become a WDAV member, too. Go to [www.wdav.org](http://www.wdav.org) to listen or get more information.



Mike McKay and Giles Almond enjoy a conversation in the WDAV studios.



## Matrix Private Opportunities Fund Reaches \$10MM in Capital

*"This announcement appears as a matter of record only."*

In 2005, Matrix ran across an excellent timber investment opportunity. Giles Almond did an office due diligence visit in Atlanta with the firm, followed up with a field operations visit by Kim Wilhelm. Everything checked out about the investment except one thing – a minimum investment of \$1 million. We were stymied – there was no practical way for the vast majority of our clients to take advantage

of this opportunity. Out of that frustration was born the Matrix Private Opportunities Fund, I, LLC (MPOF). Creating a pooled vehicle was the only practical way for our clients to access many high quality, high minimum investments normally available only to wealthy families, pensions, and endowments. This fund gives most of our clients the "buying power" to meet the minimum investments required and to access heretofore unavailable opportunities.

After countless hours and frequent flyer miles later, Matrix formed MPOF in 2007 and began introducing the fund and its rationale to our clients who met SEC "accredited investor" criteria. The response was beyond our expectations. Fifty six investors subscribed to the fund with investments totaling just over \$10 million at the time of the Fund's January 31 closing. The fund's policy is that no one investment will exceed 10% of the fund's initial

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***"This fund gives our clients the 'buying power' to...access heretofore unavailable opportunities."***

## Matrix Private Opportunities Fund [continued from page 3]

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***“Old-fashioned networking has been the primary means of uncovering many fund investment opportunities.”***

assets, so a \$10 million fund allows it to make \$1 million sized investments. No more than 25% of the fund’s initial capital will be invested in a single asset class.

The fund will invest in “alternative” asset classes, meaning things other than publicly traded equities, bonds, or cash equivalents. MPOF is intended to complement and add important diversification benefits to a traditional portfolio.

The world of private investments is different than the familiar public investments. Because they are private, and not usually marketed, they must be sought out. The old saying “it’s not what you know, but who you know” is valid when it comes to this area. Old-fashioned networking has

been the primary means of uncovering many fund investment opportunities. The due diligence process is much more hands-on, as third party research rarely exists.

We expect the fund’s investment portfolio to consist of most of the following:

- Real estate (5 managers)
- Timber (2 managers)
- Private equity (2 managers)
- Managed futures
- Hedge fund of funds
- Energy lending
- High yield debt
- Structured debt products

The due diligence process is ongoing for many of these, so the portfolio is subject to change. Even after investments are made, our monitoring work will continue.

A frequent question we received is “Are Matrix employees investing in the fund?”. The answer is that several have made material personal investments in the fund.

Will Matrix ever create another fund? We will when there are sufficient assets to justify it, which depends upon firm growth, among other things. It will realistically take around two years to reach that point.

Many thanks to Kim Wilhelm, Cindy Carroll, and Donna Barrow for their hard work in getting MPOF up and running. We also thank our legal counsel Jeffrey Hart, Robinson Bradshaw & Hinson, Scott Reckamp, Capital Markets Compliance, and the staff at the fund’s custodian Old North State Trust.

## Matrix To Offer Client Document Vault

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***“...it will give clients 24/7 access to important documents from any computer with internet access.”***

Matrix will soon be introducing a new client benefit, the online “Document Vault”. Hosted on a secure external server, it will give clients 24/7 access to important documents from any computer with internet access.

The vault will actually consist of three separate vaults: personal, CPA, and health care. The **personal vault** will

contain any documents requested by the client to be stored there. These could include insurance policies, tax returns, or a copy of the financial plan.

The **CPA vault** will be used to post tax documents useful to CPA’s during tax return preparation, such as 1099’s or gain reports. A separate password will give the CPA access to these specific documents.

The **health care vault** will contain health care powers of attorney and living wills potentially needed in a health emergency. A separate password will be used to access these documents. A card with access information will be provided to keep in your purse or wallet.

Sign up forms will be sent to clients soon.

## Neither the best nor the worst of times (continued from page 2)

Real estate securities were an especially painful place to be in 2007. REIT (real estate investment trust) shares had enjoyed a multiyear run and were very richly valued going into last year. This ended in 2007, with the sector seeing a 16% decline, the worst performance seen since the 1970's.

Commodities, on the other hand, experienced an excellent year. The Dow Jones AIG Commodities Index was up 16%, led by substantial gains in sugar, soybeans, grains, and energy. Managed futures also produced reasonably good returns, with the S&P Managed Futures Index up 7% for the year. Importantly, commodities continued to deliver positive returns in the fourth quarter (a tough time for stocks), an illustration of their diversification benefits.

2008 has proven to be a big disappointment so far for the equity markets, with the Russell 3000 broad market index down more than 10% at one point. That's the worst start to a year since 1982 and represents a 13.6% drop from October 2007, meaning we are officially in a "correction".

That's not surprising, given that earnings have already declined over the past year. However, this is mostly due to steep write-offs in the financial sector,

which make up about 20% of the S&P 500. Excluding financials, earnings growth was strong through the third quarter (about 11% year over year)—but again, financials are a big part of the market and a critical sector in the economy.

Earnings are highly correlated with the economy, so the weaker the economy, usually the bigger the earnings decline. So it's not just a matter of whether or not the economy experiences an "official" recession. Economic strength is all a matter of degree, so just an anemic period of growth could trigger an "earnings recession." That would be a headwind for stock prices. If there is a full-blown recession, earnings could fall 10% to 20% from their peak. Earnings also tend to fall back below their long-term trend line in recessions. This would suggest an even larger decline because earnings are currently far above trend. It is very possible that there will be some near-term earnings risk, depending on how much economic growth slows and for how long. The Fed would help offset some of the damage in an earnings recession by taking already low interest rates even lower. This seems the direction we are headed, and it would likely encourage investors to look to the recovery

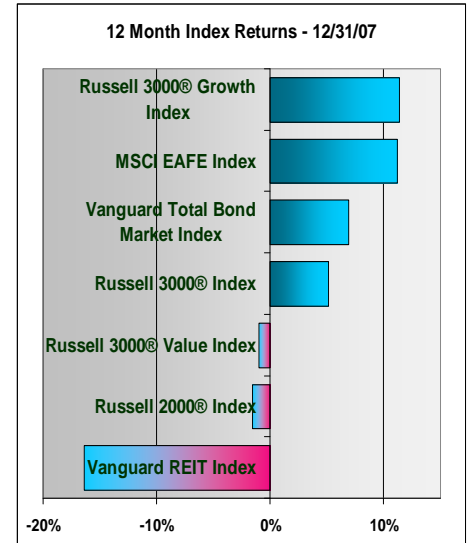
beyond. Lower rates would also mean that fixed-income investments would not provide much competition. However, lower rates will not eliminate the risk to stock investors from a material earnings recession.

Should we factor in that this is a presidential election year? Whether the election stock market cycle is coincidence or a predictive pattern is still a guess. The pattern is the year before the election year produces outside returns, which did not happen last year. Election years tend to produce average returns followed by two below average years.

It is certain that many Republican investors are concerned about the effects of a Democratic President and/or a more Democratic Congress. As the campaign unfolds, some may sell stocks, either anticipating a negative market reaction to a Democratic victory or believing that the current 15% maximum long-term capital gains rate and dividend tax rate will become historical footnotes.

Perhaps the dirty little secret is that, according to J.P. Morgan Asset Management, the economy grows faster and the stock markets gain

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## Neither the best nor the worst of times (continued from page 5)

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more, on average, under a Democratic administration than a Republican administration. Since 1948, the economy grew 1.2% faster and the S&P 500 gained 2% more per year under a Democratic president. While there are countless more variables than the President (such as fiscal policy enacted by Congress, monetary policy, foreign events, terrorism, wars, etc.) to explain economic growth and stock market returns, Republicans can take some comfort that the economy and investment markets are resilient and may continue to do quite well even if “the worst” happens.

To what extent are these risks already priced into stocks? Most traditional valuation measures suggest the market is in the range of fair value and some measures suggest stocks are at bargain levels. Of course, valuation models are based on earnings, inflation and interest rate assumptions. If a stagflation scare (which seems unlikely in the near term given the deflationary pressure from housing and credit markets) pushes the 10-year Treasury higher to, say, 6%, the stock market could fall by

more than 25%. This is a very pessimistic scenario and would qualify as a severe bear market.

We are encouraged that some of the equity fund managers we follow tell us that they are finding more compelling opportunities now than they have in the last few years. Many previously closed funds have reopened as the managers feel they can put new money to work effectively. So, while the overall market has underlying questions, we are somewhat more optimistic about the potential to add value from good stock picking. However, good values don’t always result in good short-term returns—they are more of a statement of long-term return potential.

Developed market equities had a great year in 2007 and have outperformed U.S. stocks for six consecutive years. They still look to be within a fair-value range compared to the U.S. However, both Europe and Japan, like the U.S., are showing signs of an economic slowdown. A stronger dollar is a potential risk. The strong decline of the dollar versus the euro suggests that the euro is now overvalued and there is a risk of a

currency reversal. The euro’s strength has also hurt the competitiveness of the manufacturing sector. So while the momentum is still generally with European stock markets and could continue for a while, there is not a strong fundamental or valuation case to be made. Japan does not have an overvalued currency but its economic malaise and heavy dependence on export markets has continued. On the plus side, Japanese stocks look cheap.

Emerging markets stock valuations versus the U.S. are now expensive compared to history. However, there have been improvements in emerging-market fundamentals (foreign currency reserves, trade balances, debt levels, earnings growth, capital spending levels, etc.) to justify at least part and possibly all of their higher relative valuations. We continue to depend upon our managers to make the call on how much to allocate to emerging versus developed markets.

It may sound strange but we believe all the bad news works to the advantage of persistent long-term investors. A well diversified long-term portfolio continues to be your best course.

## Worried About Recession? The Government is Here to Help!

Many were surprised when the initial Gross Domestic Product number for the fourth quarter came in at a positive .6% annual rate. That's slow growth, for sure, but it's not a contraction. Some economists were suggesting the US economy was already in a recession last year but the numbers didn't cooperate. (Officially, a recession is two consecutive quarters of negative growth.)

It's entirely possible we will see a recession later this year. According to investment manager Stewardship Partners, every time the unemployment rate has risen by .5%, a recession has inevitably followed. With the latest unemployment rate at 4.9%, it has risen by .5% from its most recent low point of 4.4% in March 2007. Based on history, a recession is almost overdue.

Even if an "official" recession is in the works, it may not be significant. The rest of the world's economies are exhibiting higher growth rates, especially developing countries, which would help buoy the US. There are not the usual warning signs of a major impending slowdown – growing inventories of unsold goods, rapidly rising wages, or a jump in initial unemployment

claims. So the recession could be short and mild.

But this is an election year and our elected leaders are not about to pass an opportunity to ingratiate themselves with the voters by throwing money at them. The economic stimulus package passed by the House features \$101B in tax rebates to 117 million individuals and expands bonus depreciation to businesses worth \$44B. Rebates for individuals would be between \$300 and \$600, \$300 for children, and phasing out by \$150,000 of income for a married couple.

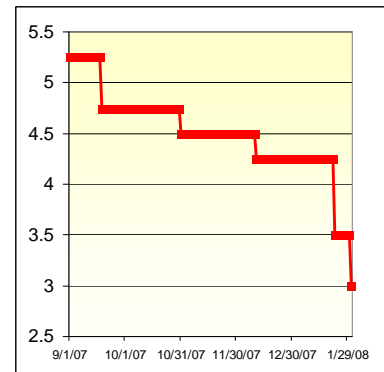
The Senate has its own embellished version, expanding rebates to non-tax paying senior citizens on Social Security, higher phaseout limits (\$300,000 for couples), extending unemployment benefits, and expanding loss carrybacks for businesses with a total price tag of \$161B. However, the House version has the President's endorsement, so it's the more likely version to pass.

The Federal Reserve and Chairman Bernanke have also been aggressively priming the pump through both its open market operations and, most visibly,

through dramatically reducing the discount rate (the rate charged by the Fed on loans to member banks). The Fed even took the step of lowering the rate in an "emergency" meeting by .75% on January 22, followed by another .5% cut at its regular meeting on January 30.

So the debate rages. Will the fiscal stimulus package be in time or large enough to make a difference? Is the inevitable addition to the national debt worth it? Has the Fed acted too slowly, remaining fixated on inflation while growth sputters to a halt? On the other hand, has the Fed acted too quickly, trying to avoid a normal, mild, healthy recession and now faces the troubling prospect of higher inflation from the excessive stimulus to consumer spending?

We're not economists at Matrix, but much of this appears to be short-term band aids focusing on the immediate and the urgent, while important long term issues are ignored. The key to future prosperity rests with consumers: can they be weaned from excessive debt financed spending to become prudent savers and investors without an economic disruption in the process? That's the question that no one is debating!



***The Fed has aggressively cut the discount rate in recent weeks.***

***“...our elected leaders are not about to pass an opportunity to ingratiate themselves with the voters by throwing money at them.”***

## Can you trust the Consumer Price Index? (continued from page 1)

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

= 100). Compared to the 201.9 reading for a year ago, the annual rate worked out to 4.3%. With milk, egg, and gas prices up substantially, many found that number hard to believe. One household's inflation experience can be very different from another's because we spend our money in very different ways. For example, my household spends more than average on education, while my mother spends more proportionally on housing and medical care.

The housing portion of the CPI may confuse some, as the BLS uses "owner's equivalent rent". This may overstate or understate the inflation felt by a

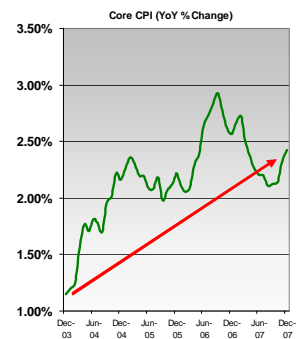
homeowner with a fixed rate mortgage.

The CPI is often referred to as "headline inflation" while the CPI without food and energy is called the "core CPI". That's because food and energy prices tend to be volatile in any one month.

The Federal Reserve and many economists use a different measure of inflation, the Personal Consumption Expenditures (PCE) deflator. This measure tracks all consumer expenditures, rather than a fixed basket of goods. The Fed looks at the "core PCE" in making policy decisions. According to Fed Governor Frederic

Mishkin, "focusing on core inflation can help prevent a central bank from responding too strongly to transitory movements in inflation."

The trend in inflation has been upward and the Fed is in a balancing act between a weakening economy, shaky financial markets, and concerns over rising inflation. While core inflation remains modest, it has been increasing.



### About Matrix Wealth Advisors, Inc.

Planning is in the process of allocating limited resources among unlimited alternatives according to a system of values to achieve life goals.

Founded in 1990, Matrix uses a very personalized, principle-centered process to offer comprehensive financial planning and investment management services that help clients

close the gap between where they are now and where they want to be. Matrix is a fee-only, fiduciary firm and is compensated solely by our clients.



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