



Quarterly Memo

July 2008

Of Special Interest:

- It's official – the bear market of '08 1
- Kim Wilhelm named CIO 1
- We're reaping the harvest from mortgage liars 3

Inside This Issue:

Meet Janice McGunnigle, CTFA 2

Making sense of crude oil prices 3

Active vs. passive management – the debate goes on 4

Mr. Bear goes to market

Pity the poor contrarian. When things are going well in the markets, instead of sharing in the euphoria, he cautions “Don’t get used to it. It won’t always be this way.” When the markets head south and pessimism is rampant, he perks up. What he’s been buying can now be purchased at lower prices – it’s on sale! Yet there’s no one with which to share the joy. He seems disconnected, almost unfeeling that the

world is in turmoil, people are in angst, and paper losses are mounting. If you’re looking for someone to share your pain and moan and groan with, he’s uninterested. It can be a lonely existence when you don’t follow the emotional crowd.

Such is life at Matrix these days. The equity markets, in reaction to economic turmoil, have entered bear market territory, defined as a 20% drop from a

peak, which occurred last October.

Continued on Page 2



Kim Wilhelm, CIMA® named Matrix CIO

Kimberly K. Wilhelm, CIMA® has been named Chief Investment Officer by Matrix President Giles Almond. “This formally recognizes Kim’s commitment to our



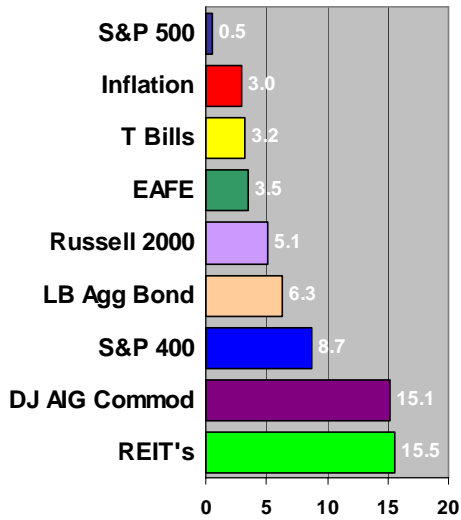
investment process, her technical excellence, and dedication to our clients’ success. During Kim’s tenure at the firm, she has daily demonstrated an in-depth understanding of portfolio management, exceptional analytical ability, and a commitment to professional growth,” he said.

As CIO, Kim has day to day decision making responsibility in client portfolios, continues to chair the firm’s Investment Committee, and plays a major role in overseeing

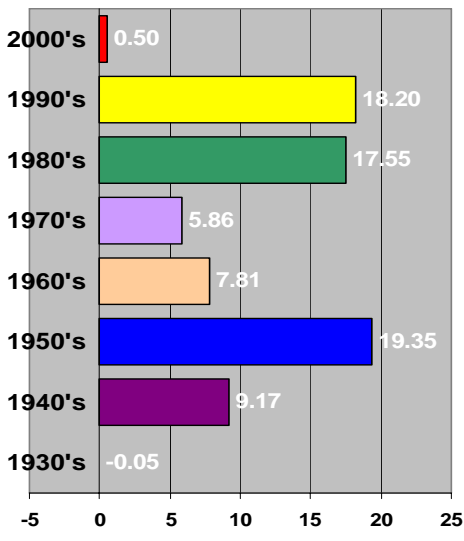
the Matrix Private Opportunities Fund I.

Kim joined Matrix in 2005 with prior experience at an investment firm in Rochester, NY, then with Wachovia’s Evergreen Funds. Holding a BA degree in Mathematics from SUNY-Geneseo, she is also a Certified Investment Management Analyst® and later earned a certificate in Alternative Investments from Wharton. She is a member of the Investment Management Consultants Association (IMCA).

Annual Returns 1/1/00 - 6/30/08



Large Stock Returns by Decade



Mr. Bear goes to market (continued from page 1)

From a longer term perspective, this is shaping up to be a historically poor decade for large cap US stocks. With 85% of the decade behind us, the S&P 500 has produced an annual return of .1%, or near zero for practical purposes. Unless market returns improve dramatically in the next eighteen months, we are on track to have the worst decade for US stocks since the 1930's. With inflation at 3.2% for the period, a 100% US large cap stock portfolio has produced negative real (after inflation) returns. Investors in diversified portfolios have fared considerably better. Returns for other asset classes typically included in a well balanced portfolio have been reasonably good – another real life illustration of why diversification makes sense.

On a shorter term basis, the first half of 2008 dramatically reinforced the idea that over the short

term the stock market is predictably unpredictable. A sharply negative first quarter was followed by two months of positive returns, but the sell-off resumed with a vengeance in June, with large-cap stocks dropping 8.4% for the month and almost 3% in the second quarter. The S&P 500 is now down 12% for the first half of this year, and is about 20% below its October 2007 high.

Recently, the markets offered few places to hide. Mid- and smaller-cap stocks fared better than large in the second quarter, but still got slammed in June and now have high single-digit losses for the first half of 2008. Foreign stocks also had a rough month, losing 9% in June and 2.2% in the second quarter. Foreign stocks are now down 10.9% through the first half. REIT's were hit hard, dropping almost 11% for the month, putting them in the red for the first half and closer to

valuation levels that are starting to look attractive relative to stocks.

Domestic high-quality bonds were flat in June, and down just over 1% for the second quarter. Though not a good return in a normal environment, bonds nevertheless provided balanced investors with a margin of protection from stock-market losses, which is part of their role. The Vanguard Total Bond Market Index Fund, our proxy for the bond market, is up 1.1% through the first half of the year.

As always happens in an environment of fear, we are being asked (and asking ourselves) a lot of questions. What is going on, and how bad could it get? Is there anything we should be doing about it? While this environment is in many ways unique and presents its own set of challenges, we've been through a number of

Continued on Page 5



Meet Janice A. McGunnigle, CTFA

Janice A. McGunnigle, CTFA has joined Matrix as Financial Planner. According to Jonie Parks, CFP®, "Janice brings valuable tax, trust, and estate experience to the firm. She will be a great asset to the financial planning team and we're delighted to have her."

Janice graduated cum laude from St. Anselm College with a BA in Business, where she was a member of the women's basketball team. She was previously a Trust Officer with Cambridge Trust Company in Boston and a support specialist with a financial planning software

company in Charlotte. Janice received her Certified Trust and Financial Advisor (CTFA) designation from the Institute of Certified Bankers. She is currently enrolled in a CFP® study program through Boston University and will sit for the exam later this year.

Mortgages and morality

What can the ongoing mortgage crisis show us about the moral fiber of this country? The answer is a lot – and it's not a good picture. One author even called it “an astounding breakdown of social norms.”

We all know by now that the housing bubble was a result of subprime mortgages made to questionable borrowers as a result of looser lending standards. Before subprime, obtaining a mortgage was like having a financial audit – all your important financial information, such as assets, liabilities, and

income, was verified by third parties. Then came the “stated income” mortgage, where the lender did not perform the normal verifications. These loans became very accurately known as “liar’s loans.” 37% of all loans originated fell into this category as recently as 2006.

Why were lenders willing to throw prudent underwriting out the door? Blame it on another recent innovation – the ability to securitize and offload practically any pool of mortgages to yield hungry investors. They simply sold the questionable

loans to outsiders, hoping that one year would pass, relieving them of any liability in case of default. The game was pocketing origination fees, not making sound lending decisions. No doubt more than a few borrowers were told “if you want to qualify, for this home, you need this amount of income” and magically that number appeared on the application.

How much lying took place? Audits of income after the fact on these loans have shown that **90%** overstated income

Continued on next page



Rising crude oil prices – is the end in sight?

You can't help but feel alarmed watching CNBC these days – the price of oil is highlighted in bright yellow whenever it sets a record, next to the caption “America's Oil Crisis”. We also feel the effects first hand at the gas pump. Clearly, we are seeing a major economic event unfolding before us. It's also one of the most complex stories to grasp, with plenty of hype, questionable data, assumptions, and disinformation to sort through. With the understanding that we are not authorities on this subject (and even the “authorities” have widely

varying opinions), we still thought it would be useful to try to bring some perspective to this multi-faceted issue.

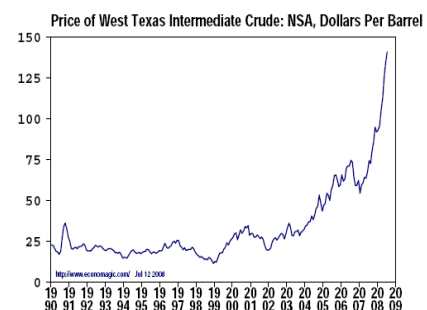
The supply of oil.

You've probably heard of “peak oil” – the theory that global oil production has or will very soon reach its maximum possible level and begin to decline. To put it mildly, there is a vigorous debate by “experts” on both sides. Depending upon which side you believe, global oil production will inexorably decline from now on or new technologies and new discoveries will postpone “peak oil” for many years.

One authority says the Saudis are producing at maximum capacity, another says there's plenty of additional capacity awaiting higher prices. About the only thing for sure is that daily world oil production has increased 1.8% since 2004 – not enough to keep up with rising demand.

The demand side. Since 2004, world oil demand has risen at a 3.7% annual rate. While US consumption is on a downward trend, economic development in China, India, Latin America, and the Middle East have more than offset declines

Continued on page 7.



“Since 2004, world oil demand has risen at a 3.7% annual rate.”

Mortgages and morality [continued from page 3]

Continued from page 3

by 5% or more and an amazing 60% overstated income by **50%** or more.

Consider the implications. Is it any wonder that home prices in many areas skyrocketed during this period? Now borrowers could get into homes previously out of reach just by putting the right number on an application – no questions asked. Legitimate borrowers were crowded out by the liars and home prices were bid up and up and up.

Predictably, these mortgages have seen defaults sooner (within months) and at much higher rates that would have been predicted by credit scores alone. Many are interest-only ARM's that converted to full amortization loans,

dramatically increasing monthly payments.

Another phenomenon seen is the loss of a sense of responsibility for the repayment obligation. My home mortgage clearly says "I promise to pay..." Yet a growing number of borrowers believe the promise no longer applies if the value of the home declines to less than the mortgage amount.

Walking away from a mortgage and foreclosure are no longer seen as anything other than a monetary decision. Our word means nothing anymore. The concept of keeping an oath, even when it hurts (Psalm 15:4) is obsolete.

A further twist on this is a technique known as "buy and bail". Let's say your house is worth \$200,000 with a \$400,000 mortgage

but your credit is still good – good enough to get a mortgage to buy a similar home for \$200,000 under the supposition you will rent out the first home. You buy the second home and walk away from the first. "It's just a business decision," says one real estate agent who helps customers with the process. Others call it mortgage fraud.

Then there's the disturbing trend for foreclosed owners to strip out and sell doors, kitchen cabinets, appliances, bathroom fixtures, gas fireplaces - even the light switches – before leaving.

In a very real way, the stock market plunge, credit crisis, and housing bust can be partly blamed on greed and dishonesty, not on Wall Street, but on our streets.

"...the stock market plunge, credit crisis, and housing bust can be partly blamed on greed and dishonesty, not on Wall Street, but on our streets."

Active vs. passive management – an ongoing debate

The subject of passive (index) investing arouses passions among some proponents that approach religious fervor. There are some sound theoretical and practical reasons that have led to its popularity.

Lower costs. Without portfolio managers, analysts, support staff, and related costs, an index fund can be operated for considerably less money than an

actively managed fund. Turnover in index funds is usually minimal, resulting in low trading and market impact costs.

Better than average performance. If you assume all active managers in a given market sector constitute the investment universe, then an index fund must produce better results than the "average" actively managed fund due to its

cost advantage.

Wide availability. Index mutual funds or exchange traded funds replicate almost every asset class. They can be broad based or narrowly focused.

Tax efficiency. Index funds tend to produce smaller capital gain distributions due to their low turnover.

Continued on Page 8

"...index funds are actively managed in a sense – by buying more and more of something the higher it goes."

Mr. Bear goes to market (continued from page 2)

crises over the past 18 years of managing portfolios. Each of those periods was different but common to them all was a sense of accelerating bad news, escalating risk, fear, and panic.

The Federal Reserve's unprecedented actions to shore up credit markets a few months back led many to hope that we were past the worst of the financial crisis and that the stock market had hit bottom. But while the Fed's actions may have significantly reduced the risk of a full-scale financial meltdown, the losses from bad loans and mortgage backed securities are continuing to be worse than expected. The boost to consumer spending and economic growth provided by rising home prices and easy credit is now gone. Add in the impacts of high levels of household debt (which suggests the need to retrench rather than spend), gas prices going above the psychologically important \$4/gallon point, noticeably higher food prices, a weakening labor market, and, by one measure, consumer confidence at a 28-year low, and it seems increasingly likely that consumer spending will continue to deteriorate. The ugly combination of a slowing economy and higher inflation (the widely feared "stagflation") has also led to questions about the ability of the Fed

to support economic growth and employment without stoking fears that it has gone soft on inflation. Economists are divided on which risk is greater: inflation or recession. Risks to the economy remain high, and the financial markets are now more fully discounting the risks, which is an unemotional way of describing the battering taken by stocks in recent weeks.

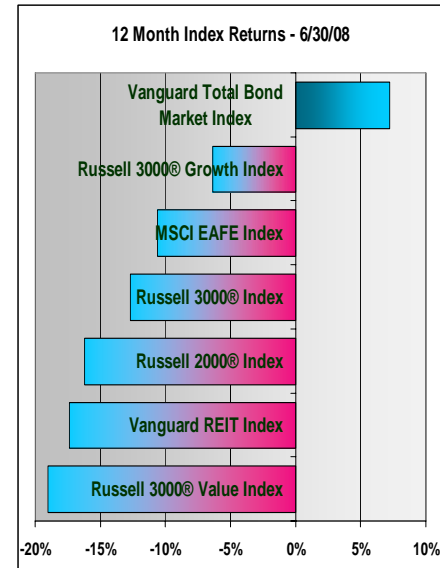
As always, there are positives as well. Outside the financial sector, corporate balance sheets remain generally healthy and earnings have been okay. One source of strength has been exports, which so far have managed to offset much of the impact of the housing decline on GDP. The Federal tax rebate helicopters have been busily dropping \$91 billion (so far) on consumers in recent weeks, which, based on past history, does a decent job in boosting consumer spending. The economy measured by GDP refuses to roll over into the "certain" recession and continues to grow slowly. Unemployment is still at a modest 5.5% level.

Through the multitude of market crises we've experienced, we recognize that history never repeats itself exactly, so almost anything can happen from

here. One possibility is that things will get worse before they get better in the stock market. Even without a bad recession, fear and pessimism could take hold of investor psychology and send the market down further than what would be justified by long-term economic fundamentals. Any number of world political events could further shake investors' emotions – just use your imagination – Israel attacks Iran, another terrorist attack in the US, a pandemic, etc. In this environment, a sense of historical perspective and a reliance on our investment discipline helps us avoid becoming panicked by short-term concerns and paralyzed by longer-term uncertainty. Like it or not, we are always faced with making decisions in an uncertain world and this will not change. However, our experience in past market cycles and our analysis of the current market environment leads us to two important conclusions.

First, we do not believe it is time to get more defensive and reduce your equity exposure based on current events. It is easy to put too much weight on negative scenarios when bad news dominates the daily headlines, but we view stocks as at least reasonably priced versus

Continued on page 6



“Any number of world political events could further shake investors’ emotions...”

benchmarks and other asset classes – something the markets seem to be ignoring in the continuing stream of negative news. Indeed, many of our equity managers report being able to buy into companies at wonderful price levels far below the intrinsic value.

Second, big market downturns and the resulting hysteria invariably present opportunities. Bubbles lead investors to make errors in judgment and misprice assets on the way up. On the way down, riskier assets often fall to bargain prices when investors are in the grip of fear. Our investment discipline (and our focus on what is knowable) helps us stay invested in those asset classes where investor panic has led to excessive undervaluation.

For example, many are lamenting about the low levels of consumer confidence, the lowest seen since 1980 and 1990. Have you looked at a stock market chart at what happened following times of extreme pessimism?

So how do you protect yourself against the onslaught of a bear market? No, it's not buying gold, short selling or market timing, which can do more harm than good. If investors followed a few simple

rules, downturns would be more "bear-able."

1) Diversify prudently. As mentioned earlier, a 100% S&P 500 portfolio has gone nowhere this decade. However, many other asset classes, while having ups and downs as well, have produced decent returns. A hypothetical fund "balanced" portfolio of 30% bonds, 20% US large cap, and 10% each in US mid-cap, US small-cap, EAFE, TR Price New Era Fund (a commodities proxy), and REIT's would have produced an annual return of 7.03% this decade.

2) Hold liquid reserves. Businesses can get into trouble when they finance long-term assets with short-term debt. Investors get in trouble when they hold long-term assets for short-term needs. Stocks have once again shown that they can lose substantial value in the short run. They almost always win versus less volatile asset classes if the time frame is long enough – ten or more years. Stocks are just not appropriate for investments that will need to be liquidated within a few years. Projected cash flows within five (and arguably more) years from a portfolio should not be exposed to equity market risk. The risk is too high that markets will be down when you need the money.

3) Spend less than you make. Having a margin of safety in your cash flow reduces the chance of needing to dip into your long-term portfolio at an inopportune time in the market cycle if an unexpected cash outlay is required. It's also the obvious way to build up liquid reserves.

4) Use debt cautiously. Why is the financial system in such turmoil these days? The answer can be traced back to excessive debt in one form or another. Bear Stearns had to be rescued because it couldn't refinance its short-term debt when other market players lost confidence in its financial strength. Foreclosures are skyrocketing because many homeowners leveraged to the hilt to buy homes that now are "under water" – with mortgages exceeding their now reduced value. Less debt means less chance of having to invade a long-term portfolio at the wrong time.

Let's be honest - bear markets are tough to live through. This one seems especially scary, with huge, seemingly strong companies like GE, Wachovia, AIG, Freddie Mac, and Fannie Mae suffering massive losses in market value. With the multiple sources of bad news, don't expect a recovery until possibly next year.

“Have you looked at a stock market chart at what happened following times of extreme pessimism?”

Rising crude oil prices – is the end in sight? (continued from page 3)

in the rest of the developed world. The US uses about 14 times as much oil as China on a per capita basis, and more than 28 times as much as India per person. As those economies develop, that gap will narrow. If China's growth in per capita oil consumption follows the pattern of Korea and Formosa during their high growth years (1980-1997), it can be expected to grow at around the GDP growth rate, currently 8-9%. The bottom line is that world demand growth will exceed increases in supply for the foreseeable future. Basic economics says higher prices will result.

The risk premium. No doubt, prices are higher due to possible supply disruptions. The current threats include an Israeli attack on Iran, Nigerian rebel attacks, and a Brazilian oil labor strike.

The speculators. In an open market, parties are free to enter into agreements with each other concerning the price of a future transaction. If you're a user or a producer of the commodity, it's called hedging. If you're not, it's called speculating – a bet that the price of a commodity will rise or fall. While considerable hedging activity takes place in the commodities markets (airlines hedging the cost of fuel,

Pillsbury hedging the cost of wheat, farmers hedging the price of corn, etc.), most activity is that of speculators. Not that anyone wants to be called a "speculator" lately. Politicians especially have become speculator bashers, usually throwing in the word "manipulation" in the same sentence.

Do speculators control the price of crude oil? Sure, but not by evil design. Speculators, on average, have believed that the price of oil is going higher. Accordingly, they are willing to "go long" oil futures, in effect, willing to purchase oil in the future at increasingly higher prices. So far, they have been correct and richly rewarded. If you're an oil producer, why should you sell for anything less than the price speculators (i.e. the futures market) have set in the world market?

The same futures market can also drive down the price of oil. If speculators as a group become convinced that the price will be lower in the future, those willing to "sell short" oil futures will outnumber those willing to go long, driving the price downward.

Commodity index funds. While over \$250 billion is invested in these funds, we think they play a small role in

raising prices. These funds invest in futures contracts or notes, not actual barrels of oil. In theory, you can create an unlimited number of futures contracts without affecting the actual demand for the underlying commodity.

Could we be in an oil bubble? Possibly. Prices could quickly drop back into double digits – or continue upward.

How long will prices go up? As long as we continue to think they will.

Final perspective. Gas prices in Europe top \$8/gallon. We can buy all we want at \$4. Higher oil prices are part of the long term solution. Until oil prices get high enough to spur the use of alternatives (wind, solar, etc.) and more conservation, we will stay addicted to oil. The high prices are a real economic challenge. Nevertheless, they are a necessary catalyst to the goal of energy independence. While research has been going on for years, new energy technologies do not become commercially feasible overnight and decades may be required before the goal is in reach. If capitalism and the pursuit of economic profit are the driving force for energy independence, based on history, it will succeed.

"...world demand growth will exceed supply for the foreseeable future. Basic economics says higher prices will result."

Active vs. passive management – an ongoing debate (continued from page 4)**Matrix Wealth Advisors, Inc.**

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Indexers argue that the superior performance of some managers is just luck - random chance – and if skill does exist, it can't be identified in advance. They point to the lack of persistency of top performing managers.

Proponents of active management argue that talent exists in investment management just like sports. Distinguishing luck and skill may be difficult but not impossible. Studies show persistency of *below average* performance exists, so identifying and avoiding mediocrity increases the odds of above average performance.

About Matrix Wealth Advisors, Inc.

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

Popularity contest.

Almost all index funds are cap-weighted, meaning a stock's weight depends on its market value. This means that as a stock becomes more popular, it carries a greater and greater weight in the index. In other words, index funds are actively managed in a sense – by buying more and more of something the higher it goes (normally not a good idea). Some index funds are equally weighted to deal with this and a few use a new concept, *fundamental indexing*.

Efficient markets. Theory would predict that indexing would work best in large cap stocks in well

developed markets where an abundance of company information exists, such as the US and the evidence seems to bear this out. Active managers do best in small cap and foreign markets, where markets are clearly less efficient.

Our take. Unlike “true believers” in indexing, we're agnostics. Our quantitative models are free to select index funds but rarely do. We believe talent exists and spend enormous effort trying to identify it. Enough non-professionally managed (i.e. dumb money) assets exist that carefully selected active managers have decent odds of long-term outperformance.

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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