

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

Distributed to our clients and friends weekly

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Friday, June 20, 2008

Markets Sour As Oil Remains Stubbornly High

We can't seem to catch a break with oil. Just as the Saudi oil minister's preaching that prices are too high starts them falling, news that Israel's recent massive military exercises are aimed at ending Iran's nuclear programs brings them back up again. Given the preponderance of upcoming possible and potential ill-boding events for oil supplies, it's hard to see prices anywhere close to the minister's suggested 'reasonable' price of \$100 per barrel. Tack on an exclamation point here at home as Congress refuses to plan for or allow more drilling or refineries, and shows no constructive movement toward conservation or alternative energy.

Will there be change in November/January? In talking to experts in the political realm of renewable energy the answer is an underwhelming maybe, but probably not meaningful. Any help from the government in the form of tax credits and subsidies must be paid for in taxes from somewhere else and each side is so absolutely entrenched against one the other that meaningful progress will come very slowly. John McCain's and President Bush's calls this week to open up the continental shelf and Alaskan Arctic Refuge for drilling were answered with comments like the one from House Appropriations Committee member Maurice Hinchey of New York: "We should own the refineries and control how much gets out into the market."

Does the congressman truly believe refineries are holding back gasoline to drive prices higher? While his views sound radical to free-market minded individuals, they clearly express the emotional gulf between Republicans and Democrats on energy. We hope beyond hope that logic and reason will win out over emotions and short-sightedness. This country badly needs to address energy on every front. The 'pearl harbor' of our energy crisis was in the 1970's. It's high time the 'sleeping giant' was awakened to action. Can you McCain, or you Obama, be our Roosevelt?

On the credit front, improvement remains elusive. Citigroup, Bank of America, Wells Fargo, Wachovia will all post significantly lower earnings this quarter on write-downs from subprime-infected investments. Merrill Lynch says US regional-bank stocks are in "capitulation mode" and cut share-price estimates again. Lehman said losses at the nation's largest mortgage companies Freddie Mac and Fannie Mae, may grow. Moody's, Fitch Ratings, and S&P finally stripped MBIA and Ambac Financial (municipal bond insurers) of their AAA ratings. Merrill, Goldman Sachs Group Inc. and Lehman also dropped this week. The S&P 500 has slumped 14% from its all-time high in October on concern credit-related losses approaching \$400 billion, record oil prices and higher inflation will push the US economy into a recession.

The housing crisis continues with some analysts fearing it is accelerating. Housing starts reported this week, within the Leading Indicators report, were the worst in 17 years. Building permits, a sign of future construction, fell 1.3% to a 969,000 annual rate in May. As consumers learn that the value of their house is falling, their willingness and ability to spend falls right along with it. Consumer spending showed a boost this week in higher retail sales, but will likely fall off as the boost from the tax rebate checks diminishes. The consumer drives our economy.

Until oil prices fall with confidence that they will stay low, we remain bearish on stocks, globally. We continue to take a more conservative posture with the conviction that economic improvement will come more slowly than earlier thought.