

# PRAETORIAN<sup>SM</sup> GUARD



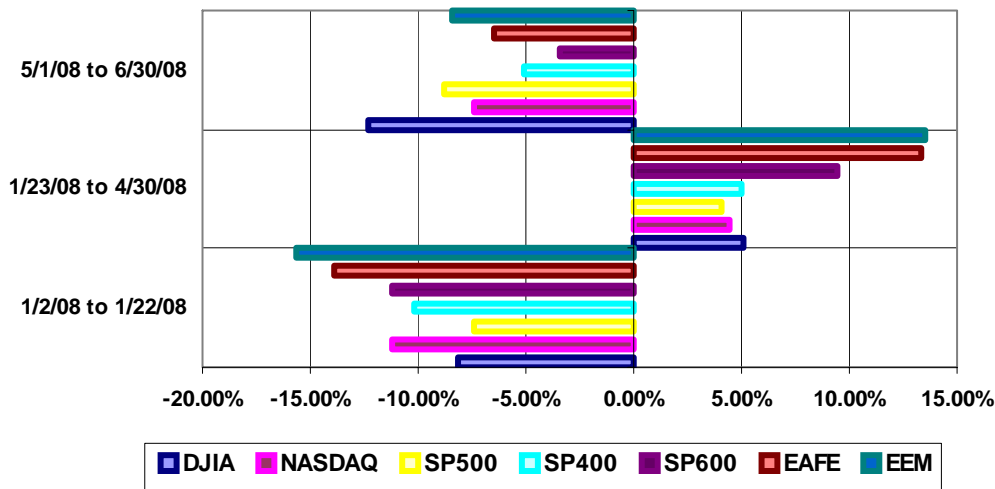
**CLIENT NEWSLETTER**  
**JUNE 2008**

## 2008 YEAR TO DATE MARKET COMMENTARY

We have experienced a brutal first half of the year in the equity markets with very few, if any, bright spots. Virtually all the major indices, both US and international, have been down by 10% or more and are now at or near bear market levels (defined as down 20% from their most recent peak in October 2007).

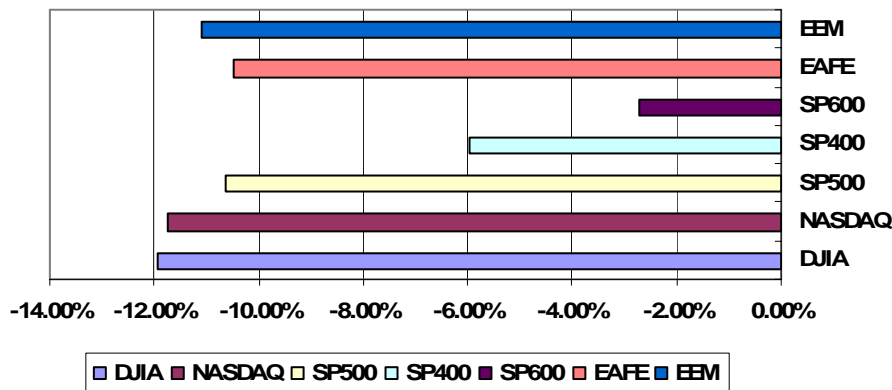
Our analysis identifies three different phases which have combined to make the first half of the year a very trying one. The period of January 1st to January 22nd observed a strong decline in all markets, with the largest contributing factor being a continuation of the fallout of the credit crunch which started in Q407 and anemic GDP growth for the final quarter of 2007 (0.6%). The second phase was a settling of the market during the period January 23rd to the end of April. Most of the major averages regained some of their initial losses from January with positive short term return to end the first four months in slightly negative territory (-3% to -5%). Finally, May and June were brutal as oil surged 25% on top of the 16% of the first four months of the year and markets ended up in a steep decline.

**A Tale of 3 Markets**



Source: Bloomberg

**Equity Index Returns for 1st 6 Months of 2008**



Source: Bloomberg

## PRESIDENT'S COMMENTS

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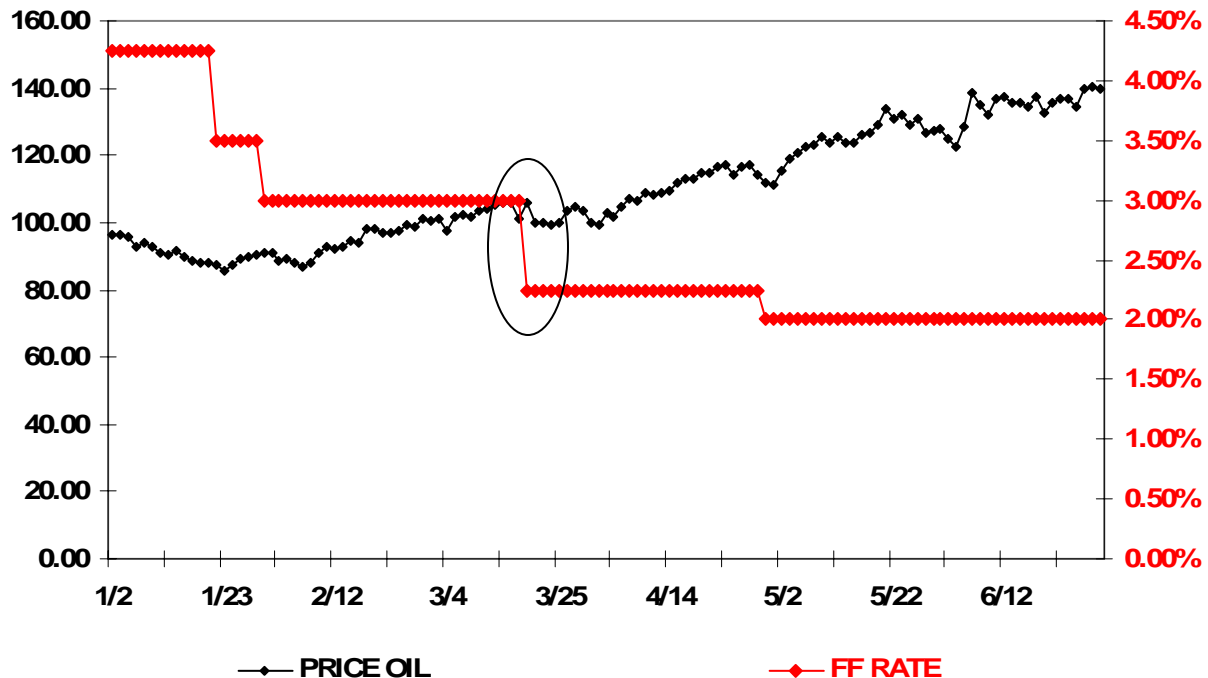


Dick Hewitt

### 2008 YEAR TO DATE MARKET COMMENTARY (CONTINUED)

The major causes, in our view, of the equity markets' split personality are the intersection of the corporate credit crunch caused by the unwinding of the credit derivative markets and the continued housing price declines forcing the Federal Reserve's hand on lowering interest rates to spur economic growth. In isolation, that *may* have been the correct short run economic prescription, but with the dollar already weak against foreign currencies, it forced an acceleration in the price of commodities, most acutely oil.

The Federal Reserve has lowered rates four times from 3.50% to 2% in the period January 22nd to April 30th and oil has moved from a year low of \$85.42 a barrel to \$140.00 on June 30th, a 63% rise. While supply constraints are clearly a contributing factor, our analysis of the data is that the Fed's decision to make the third 75 basis point rate cut on March 18th oil prices rising significantly higher due to the perception created that the Fed was abandoning its inflation fighting stance. The chart below shows the large rate cut and the ensuing 32% rise in the price of West Texas Intermediate crude per barrel.





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## SO WHERE DOES THIS LEAVE US FOR THE REMAINDER OF THE YEAR?

We believe the Federal Reserve has realized its loose money actions to increase liquidity in the market place along with the other expansions of credit to investment banks has come dangerously close to creating higher, permanent inflationary expectations.

This creates the potential for a 1970s repeat of slow growth AND higher prices driven by oil prices and a lack of will on the Fed's part to take action. We believe, however, that the Chairman and several of the Fed's regional bank presidents have changed their orientation from fighting slow growth to fighting inflation. This would be a welcome, and overdue, action.

We have been increasing our cash holdings slightly and adding to commodity exposure over the last six to nine months in your portfolios. We expect to take smaller positions in consumer staples and health care over the next few weeks as a defensive measure.

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### CLOSING THOUGHT

“Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it.” —**Warren Buffett**