



Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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MAY 2008 COMMENTS

MAY 2008 MARKET ACTIVITY (ending Friday, May 30th)

US and international STOCK prices followed up their excellent April results with mostly positive results for May, ranging from significant gains for the NASDAQ Composite, Midcap and Smallcap; to more modest gains for Total US, S&P 500, Developed International and Emerging Markets; to negative for the Dow Jones Industrials. However, year-to-date (YTD), these indexes remain negative, but with narrowing declines. High credit quality taxable BOND prices continued their April declines, after months of strong results during the period when stock prices were declining. Municipal bonds, on the other hand, showed modest positive results. (See pages 2 and 3 for more details).

Our basic position (abbreviated here) throughout the most recent period of financial turmoil has been set out in our previous Monthly Comments: "If the history of stock price recoveries is to repeat, the current problems need to be overcome.... There are no assurances or certainties here, only the knowledge that prior periods with significant problems experienced stock price recoveries." This remains our core view of the current situation, and why we advise our clients to stay with their current portfolio allocations.

This month we will discuss high oil prices, and their impact on financial markets and the economy.

IMPORTANT UPDATES:

Firm Brochure: We have prepared a brochure that we will be distributing soon. We hope you take the time to review it, and consider referring us to people you know who are interested in working with an investment advisory firm that provides quality, low cost advice that helps clients achieve their goals with indexed investments.

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Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.

COMMENTS: INDEX RESULTS for period ending MAY 2008

	<u>YEAR</u>	<u>YEARS</u>	<u>YEARS</u>	<u>YEAR</u>	<u>YEAR</u>	<u>YTD</u>	<u>MAY</u>
<u>STOCKS</u>	<u>1999</u>	<u>2000-02</u>	<u>2003-05</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2008</u>
Vanguard Total Stock Market Index Fund (1)	23.8%	(37.2%)	53.1%	15.5%	5.5%	(3.0)%	2.0%
Standard & Poor's (S&P) 500 Index (2)	19.6%	(40.1%)	41.9%	13.6%	3.5%	(4.6)%	1.0%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(48.4%)	41.8%	9.0%	12.6%	(1.2)%	3.5%
Vanguard S&P 500 Value Index Fund (1)	12.6%	(26.2)%	63.2%	22.1%	0.1%	(5.6)%	(0.3)%
Dow Jones Industrial Average Index (2)	25.2%	(27.5%)	28.5%	16.3%	6.4%	(4.7)%	(1.3)%
NASDAQ Composite Index (2)	85.6%	(67.2%)	65.2%	9.5%	9.8%	(4.9)%	4.1%
Vanguard Midcap US Index Fund (1)	25.0%	(18.3%)	83.9%	13.6%	6.0%	(0.3)%	4.2%
Vanguard Smallcap US Index Fund (1)	19.6%	(24.2%)	87.5%	15.6%	1.2%	0.7%	4.9%
Vanguard International Index Fund (EAFE) (1)	25.3%	(45.9%)	95.9%	26.6%	15.5%	(2.1)%	1.5%
Vanguard Emerging Markets Index Fund (1)	61.6%	(29.5%)	162.7%	29.4%	39.0%	(1.5)%	1.7%
Vanguard Real Estate Investment Trust Fund (1)	(0.4%)	47.5%	98.6%	35.1%	(16.5)%	8.3%	0.2%
 <u>BONDS</u>							
Vanguard Total Bond Market Index (1)	(0.8%)	30.4%	11.1%	4.2%	6.9%	1.0%	(0.8)%
Vanguard Intermediate Tax- Exempt Index Fund (1)	(2.9%)	23.7%	10.3%	4.4%	3.4%	1.5%	0.6%
Vanguard Short-term Bond Index (1)	2.1%	25.8%	6.5%	4.1%	7.2%	1.8%	(0.3)%
Vanguard Short Tax- Exempt Index Fund (1)	2.6%	13.8%	4.5%	3.2%	4.2%	1.8%	0.3%
Vanguard High-Yield Bond Fund (1); starting 2002	NA	1.7%	30.7%	8.2%	2.0%	0.9%	(0.2)%
Vanguard Inflation-Protected Bond Fund (1); starting 2001	NA	25.5%	20.0%	0.4%	11.6%	3.2%	0.1%

NOTE: Three-year results start with a base of 100, and after each year's % change, the result for that year creates a new base. So if at the end of the first year the index is up 10%, then the new base is 110%; and if down 10%, then the new base is 90%. NOTE also that a decline of 50% requires a gain of 100% to get back to the starting value, which explains why NASDAQ, down 67%, would require a gain of 200% to get back to its starting value.

- 1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.
- 2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q			
		<u>1999</u>					<u>2000</u>					<u>2001</u>			
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1			
NASDAQ	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3			
BONDS	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0			
		<u>2002</u>					<u>2003</u>					<u>2004</u>			
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8			
NASDAQ	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9			
BONDS	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0			
		<u>2005</u>					<u>2006</u>					<u>2007</u>			
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)	5.2	6.6	0.2	5.8	1.6	(4.1)			
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)	3.9	7.1	0.3	7.5	4.0	(2.0)			
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)	3.8	1.3	1.4	(0.6)	2.9	3.2			
		<u>2008</u>					<u>2009</u>					<u>2010</u>			
S&P 500	(9.9)														
NASDAQ	(14.1)														
BONDS	2.2														

MAY 2008 COMMENTS

STOCK index prices for US stocks were mostly higher in May, with the Total Stock Market, S&P 500, and NASDAQ indexes up in a range of +1% to +4%, while the Dow Jones Industrials were down -1.3%. Year-to-date (YTD), these four indexes are still negative, in a range of -3.0% (Total Stock) to -5.0% (NASDAQ). International and Emerging market indexes were also higher for the month, but still down -1.5% to -2.0% for the year. The best monthly performer was Small Cap. The best YTD performer continues to be REITs, which were the worst performer in 2007, following years of outperformance (see details in the chart on page 2).

BOND returns (price change plus interest) for the higher credit quality part of the taxable bond market were lower for the second consecutive month, but all of these categories are still up YTD. Municipal bonds gained for the month, and are also up YTD. Lower credit quality junk bonds and Inflation Protected bonds had slight monthly changes, and continue to be up YTD. The benchmark 10-year US Treasury yield closed at 4.05%, up a significant 31 basis points (bps) from April's close of 3.74%, which in turn was 31 bps above the low rate of 3.43% reached in March. Note that as interest rates move higher, prices for existing bonds move lower.

ECONOMIC NEWS was mixed, with some indicators more positive than expected. Some commentators are now questioning the inevitability of the economy falling into recession. While concerns continue about the ongoing decline in housing prices and problems in the credit markets, the larger concern for now seems to have shifted to higher inflation, fueled primarily by soaring oil prices, which are the subject of our discussion starting on page 6.

From a longer-term standpoint, the recent housing and credit problems triggered the five-month stock market retreat from the October 2007 highs, which appears to signal the end of the 2003-07 recovery from the severe bear market of 2000-02. Whether the April-May rally continues into the future is, however, unknown. Reviewing the period from the 2000 highs to May 2008, the Dow Industrials are 8% higher, the S&P 500 8% lower, and the NASDAQ still a stunning 50% lower. Thus, the annualized returns for all three indexes since 2000 are far below their long-term average annualized returns. The mutual fund company Vanguard notes that from 1926 through 2005, in only six of 80 years did stock prices fall within 2%, up or down, of the long-term annual average return of plus 10.4%.

However, going back further to the bull market that began in 1995, all three major indexes have similar average annual returns, ranging from 8.7% to 9.4%. (These returns are, however, below the 10.4% annual average dating back to 1926.) As they converge, “regression to the mean,” described by Yale endowment manager David Swensen as “one of the most powerful influences in the world of finance” seems apparent. But Vanguard’s observation is also meaningful, since annual returns during the bull market were far higher than the long-term averages, and the returns from 2000-May 2008 have been far lower.

The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, even with (so far) a fairly stable very-long-term average return. Key Questions: Your relevant time frame and tolerance for risk.

	<u>S&P 500 (1)</u>		<u>DOW (1)</u>		<u>NASDAQ (1)</u>	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year End 2007	1,468	(4)%	13,265	+13%	2,652	(47)%
May 31, 2008	1,400	(8)%	12,638	+8%	2,523	(50)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999

	<u>S&P 500 (1)</u>	<u>DOW (1)</u>	<u>NASDAQ (1)</u>
End 1994	459	3,834	752
End 1999	<u>1,470</u>	<u>11,500</u>	<u>4,070</u>
Gain	1,011	7,666	3,318
Avg. Ann. % Gain: '95-'99; 5 years	26.2%	24.6%	40.2%
MAY 2008	1,400	12,638	2,523
Gain	941	8,804	1,771
Avg. Ann. % Gain: '95-5/08; 13.42 yrs	8.7%	9.3 %	9.4 %

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA’s fees.

INVESTMENT CONCEPTS

The chart below, which we introduced with our November Comments, has been updated to reflect the extreme volatility of the months since the summer of 2007. The month of May actually reflected a marked reduction in stock price volatility.

	S&P 500	Change from YE06	Dow Jones Industrials	Change from YE06	NASDAQ	Change from YE06
YE 2006	1,418	-	12,463	-	2,415	-
7/19/07 High	1,553	9.5%	14,000	12.3%	2,720	12.6%
8/16/07 Low *	1,370	-3.4%	12,456	-0.1%	2,387	-1.2%
10/9/07 High	1,565	10.4%	14,165	13.7%	2,859	18.4%
12/31/07 Close	1,468	3.5%	13,265	6.4%	2,652	9.8%
1/22-23/08 Low *	1,270	-10.4%	11,635	-6.6%	2,202	-8.8%
3/17/08 Low*	1,257	-11.3%	11,756	-5.7%	2,155	-10.8%
5/31/08 Close	1,400	-1.3%	12,638	+1.4%	2,523	+4.5%

* Note - Lows from 8/16/07, 1/22-23/08 and 3/17/08 are not closing prices, but daily ("intra-day") lows

Some key observations from the chart:

- 1) From the 10/9/07 highs to the January and March intra-day lows, the S&P 500 was down 19.6%, the Dow Industrials down 17.9%, and the NASDAQ Composite down 24.6%. Those are major declines in a matter of months.
- 2) The October 2007 recovery from the August 2007 lows, and the April-May 2008 recovery from the March 2008 lows, were both substantial, ranging from 10% to 20% in most cases, and occurring in very short time frames. These recoveries illustrate the dangers of exiting the stock market after a period of declines, on the assumption the declines will continue.
- 3) There is no way to determine at what point the lows for this market cycle will have been reached until long after the cycle has been completed.

High Oil Prices and Their Impact on Financial Markets and the Economy

Everyone now knows that oil prices have recently been hitting historic highs on an almost daily basis. On May 7th, the NY Times (NYT) reported crude oil per barrel closing at a record price just under \$122 (C1). The price continued to rise during most of May, went above \$130, fell back to \$126 towards the end of May (NYT, 5/30, C7), and went as low as \$122 the first few days in June. During the last two days of the first week in June, oil prices soared \$16 to reach a new high. On Friday, 6th alone, "Crude oil notched its largest price jump ever, leaping nearly \$11 to more than \$138 per barrel, on news of a weakening dollar and continued jitters over the reliability of world supplies. The surge, coming just as many analysts thought oil prices were set to fall, sent stocks plunging amid fears that the U.S. economy could be in for a combined bout of inflation and slow growth. (WSJ, 6/7-8, front page). Along with this rise in the barrel price of oil, gasoline prices were closing in on \$4.00 per gallon in the United States. By comparison, in Europe, where taxes on gasoline are considerably higher than in the U.S., per gallon gasoline prices range from \$7.00 in the U.K., to \$7.80 in France, and over \$8.00 in Germany (WSJ, 5/28, A8; NYT 5/30, C5).

The financial media has attempted to identify the causes of the price increases, which include increased demand, constrained supply, financial speculation, and the recent decline in the value of the dollar. A WSJ editorial (5/23, A14) observed that as recently as August 2007, oil prices were \$70 per barrel in the U.S., and that if the dollar had stayed even with the euro since then, the dollar oil price would be closer to \$80 than \$130. "No one denies that supply and demand play a role in commodity prices, but oil on global markets is denominated in dollars. When the value of the dollar falls, and especially when speculators anticipate that it will fall further, oil sellers demand more dollars for their product."

The current media reporting on financial markets has also taken to linking the daily change in stock prices to the daily change in oil prices; stock prices decline due to a rise in oil prices, and stock prices rise due to a decline oil prices. While that causal connection worked for most of May, it completely changed during the first week in June, until the trading of June 6th. When oil prices declined during the first four days of June, so too did stock prices. And on the day the stock market rose approximately 2%, oil prices rose over \$5 (trading results of Thursday, June 5th). On Friday, June 6th, however, when oil prices rose over \$10 (the most ever in dollar terms), the stock market declined over 3%. (There was also negative news on employment in the U.S. on Friday).

At Park Piedmont, we have always been skeptical about using one factor to explain the movement of stock prices, because we believe stock prices are impacted by a myriad of factors and trying to isolate one oversimplifies the idea of causation. While the trading results on many days followed the pattern of rising oil prices/declining stock prices, and vice versa, there have also been many days when this connection simply has not held up. So we caution against simply looking at this one factor as driving stock prices.

Rather, we suggest reviewing how the rising price of oil impacts the overall economy. We think that it is these effects that are most likely, over any reasonable time period, to have the real impact on stock (and bond) prices.

The following are the major impacts of high oil prices on the economy:

1) High oil prices increase the rate of inflation, which in turn has the tendency to cause a slowdown in economic activity. Almost by definition, higher oil prices set the stage for a higher rate of inflation in the general economy. Inflation occurs when the general price level in an economy rises. Since oil is a basic commodity in any developed economy, as oil prices rise, inflation rises as well.

As the price of oil increases, people have less money to purchase other goods and services. This in turn has the consequence of slowing down the economy. The more money consumers spend to fill their gas tanks, the less money they have for other uses. The most direct impacts are on the amount of driving itself, and activities related to driving or that are considered discretionary. Examples include reduced leisure travel, fewer purchases of vehicles that use large amounts of gas, and fewer purchases of other high priced items not deemed essential to buy on an immediate basis. "The skyrocketing price of oil, now up more than 44% so far this year, is battering the airline and auto industries and causing consumers to cut back on driving and nonessential spending" (WSJ, 6/7-8, front page, far right column).

2) Interestingly, the general slowdown in economic activity, occasioned in part by high oil prices, also has the potential to slow the rise of other prices, as producers of goods and suppliers of services compete for the shrinking amount of consumer dollars by lowering prices. While this may help companies maintain the production levels of their goods and services, it most certainly also has the consequence of reducing the profitability of these companies. Declining profits in turn have a direct impact on the stock prices of the companies affected. Lower profits generally equal lower stock prices. "The headwinds for corporate profits are gathering force. The credit crunch and a squeezed consumer have already put an end to a record run of earnings growth. Now, as the second quarter enters its final month, the energy crunch is taking a bigger bite out of profits just as many analysts thought earnings would be better....Ford and Dow Chemicals surprised investors with news that earnings are likely to suffer as a result of higher commodity prices....Airlines are taking a beating from higher fuel costs, and retailers and restaurants are suffering as high gas prices keep consumers away....One bright spot appears to be technology companies, which are benefiting from the export boom driven by the weak dollar and have few of the raw material cost problems hurting other sectors (WSJ, 6/2, C1). A similar theme was expressed in a front page NY Times article (Sunday, 6/8): "Surging oil prices are beginning to cut into the profits of a wide range of American businesses....They find themselves forced into unpleasant choices: should they raise prices, shift to less costly procedures, cut workers, or all of the above....With the vice on corporate profits tightening, and the price of oil continuing to climb, more dire action, including job cuts and higher prices, may be in store."

3) The same slowing economy also typically creates less of a demand for money, as companies cut back on their spending for employees, inventories, and plant and equipment. This reduced demand for money generally leads to lower interest rates. This consequence, over time, has a stimulative affect on the economy. Indeed, the Federal Reserve's recent policy on interest rates has been to lower the short term rates that it controls from a high of 5.25% less than a year ago, to a low of 2.0% (the present rate). This dramatic rate reduction has been made in the context of rapidly declining housing prices and the major problems in the financial markets that were initially triggered by these falling housing prices, all of which have spread to the general economy in the form of an economic slowdown. Interestingly, falling housing prices have helped keep inflation down, as housing is a key cost component in calculating inflation.

4) Ironically, lower interest rates have, as one consequence, a decline in the value of the U.S. dollar, relative to currencies of other countries that pay higher interest rates or have more favorable economic outlooks. The declining value of the dollar has a direct relationship to the price of oil, since oil prices are denominated in dollars. If the dollar buys less, the producers of oil demand more dollars to maintain their purchasing power. Lower interest rates also lead to higher prices for existing bonds.

5) The reduction in the need for employees, while reducing costs for companies, also reduces wages for the affected employees. As wages decline, the ability to purchase goods and services, including oil, also declines. Therein lies the seeds for a reduction in prices/inflation, which also has the effect of getting people to purchase more goods and services. Of course, the key question in any economic slowdown is how long and how deep the slowdown becomes, and whether the slowdown creates the conditions for a recovery or feeds on itself and becomes more and more severe. Each slowdown creates its own history, but government actions such as the recent tax rebates and interest rates cuts are both key efforts to keep the slowdown from worsening.

6) As should be obvious from this discussion, single economic factors, even ones as important as oil prices, have a variety of impacts, some of which tend to drive the economy further in one direction, while others have a counter-balancing effect. The results of these impacts will in turn determine how quickly stock prices recover and move higher, and, most likely, how quickly interest rates turn higher and bring bond prices down. The time period in which these changes take place is of course crucial in determining the investment returns that are earned over any relevant time period.



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