LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"Every great mistake has a halfway moment, a split second when it can be recalled and perhaps remedied."

Pearl S. Buck (1892-1973)

The above quote is not meant to suggest that we need to prepare for gloom and doom, but to remind us that the investment markets will not necessarily behave as they did in 2006. Many market watchers have been calling for economic weakness for well over a year now. Based on experience, it is important to wait for the market to confirm any forecast (positive or negative) rather than try to guess or time when the current trend may change. As an example, many money managers missed substantial gains in the last eighteen months while they based their allocations solely on opinions or forecasts.

During 2006, the U. S. economy was characterized by strong corporate profits that resulted in an increase in business capital investment, continued deficit spending from our government, and the booming emerging market economies, offset somewhat by the slowdown in domestic consumer spending (a result of the Fed pushing short-term rates higher). Looking forward to 2007, we suspect that the economic slowdown is not yet behind us. Housing starts and sales are likely to continue declining, while prices (which lag sales) will modestly drift lower. The delayed effect of the housing slowdown will probably act as a drag on consumer spending as home equity borrowing slows. This slowdown—just enough to ease inflationary pressure, but not enough to push us into recession—has become known as the proverbial *soft landing*. Risks to a *soft-landin*g scenario include another spike in oil prices, a collapse in the dollar, sharply decelerating corporate earnings, and the ever present potential of a major terrorist attack.

The *soft-landing* scenario is sometimes referred to as the *Goldilocks* economy—not too hot, not too cold, but just right. In a typical business cycle, imbalances are created during an upturn (record trade deficits, record consumer debt, a negative savings rate, and inflated home prices) which are corrected during the downturn. Belief in the *Goldilocks* economy permeates Wall Street forecasts. The fact that economic history books contain no such occurrences of *Goldilocks* economies, but are loaded with business cycle upturns and downturns, doesn't seem to be bothering the market one bit—another example of the *this-time-it's-different* syndrome.

With economic indicators and worldwide tensions lining up in the bearish camp, it's prudent to review history and your current asset allocation. The majority of well-intentioned investors have a real job and a real life outside of the financial markets, which limits their ability or desire to follow the financial markets on a daily basis. This typical investor understands the need to be diversified or to *spread out* the risk in his investment portfolio. Using investments from several different asset classes, investors can do very well even in bad times for the economy and the major U. S. stock indices.

Bull markets have a tendency to make us forget about the benefits of asset class diversification. Since we are now into year five of the current bull market in U. S. stocks, don't make the mistake of forgetting to check on your portfolio's asset allocation.

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