

# Oakwood Outlook

## & Quarterly Review

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"We're expecting stocks to rally but we don't know which ones and when."

### WORD FROM THE ADVISOR

## There Is No Crystal Ball . . . and You Don't Need One to Invest Wisely

Imagine you are at the big football game, one that you have been anticipating all season. Your friends have volunteered you to go to the snack bar and get drinks and hot dogs for everybody. While in line, you hear the roar of the crowd, and then the announcer yells "Touchdown!!" Oh, you say to yourself, I missed it! What are the odds of that happening? Then, after waiting in line for what seems like an eternity, you head back to your seat. You're walking down the tunnel to the field. *Again* you hear the roar of the crowd, and *again* you hear "Touchdown!!" This scenario can *feel* a lot like investing, if you don't stay invested in a broadly diversified portfolio. You have to stay in your stadium seat to experience the touchdowns, because you don't know when they are coming. **Similarly, you have to stay invested in a diversified portfolio to experience the full potential of returns the market will deliver, because no one can forecast which individual stock or which asset class will be the best, or when.** And even though no one can predict the future, you don't need to in order to have a successful investment experience.

Historically, the track record of market forecasters highlights the fact that experts can be and, many times, are wrong in predicting both the upside and downside. For instance, 90% of economists failed to pre-

dict the 1990 recession. The largest investment houses forecast a bull market in Mexican stocks just before the government devalued the peso and sent stock prices reeling. Virtually no one predicted the seven-year decline in interest rates starting in 1991, rewarding those who held fixed income. Senior market analysts incorrectly predicted the coming of a bear market numerous times between 1994 and 1998. Few foresaw the hyperinflation of the late 1970s. When Wall Street finally recognized the inflationary spiral trend, it expected more of the same, promising investors that gold could rise to \$2000 an ounce and oil to \$100 a barrel. In the last year, at about the same time, most economists wrote off hopes for the sagging US steel industry, which rebounded by the 1990s to become the world's most efficient and profitable once again. Experts claimed the recession would be much worse than it was in 2002. There was endless debate in the late 1990s and early in 2000 about the endless upward valuation of internet stocks, some feeling correctly that the bubble would soon burst, others predicting the "new paradigm economy" was the new standard.

The majority of market pundits were predicting gloom and doom after the huge collapse in the credit and hedge fund market in August, and yet we stand today near all-time highs across many major markets.

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### OAKWOOD EARNS "TOP DOG" HONORS

Oakwood Capital Management LLC is pleased to announce that it was ranked as one of the star players in the seventh annual *Wealth Management Top Dog Survey*. *Wealth Management* is a bimonthly publication that provides insight and information to the financial community. The *Top Dog Survey* provides interesting statistics about wealth management firms.

How does Oakwood measure up? With respect to experience, one of

the most interesting facts is that of the five hundred firms in the survey, nearly 20% are less than seven years old. You can take comfort in knowing that Oakwood was established over nine years ago, and that our professional staff has over 260 years of combined professional experience. As is the case with many of the other "Top Dogs" from the survey, at Oakwood, we are not looking to maximize the number of clients. Rather, we are looking to maximize our clients' wealth management experience, and to provide the very best in client service. ■



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The table below highlights an interesting update on the S&P 500 market performance after periods of extreme volatility.

### Market Performance After Volatility Spikes

Date of volatility spike	Volatility 50-day rate of change	S&P 500 Change After Volatility Exceeds 90%		
		One month later	Three months later	Six months later
8/23/1990	109.8%	1.4%	2.6%	18.9%
4/4/1994	113.9%	3.2%	1.7%	5.2%
8/31/1998	102.0%	9.5%	21.6%	29.1%
9/17/2001	119.1%	4.9%	9.2%	12.2%
7/22/2002	94.2%	16.0%	9.7%	8.3%
6/13/2006	109.0%	4.0%	7.3%	15.4%
8/16/2007	108.0%	2.8%	?	?
<b>Average</b>	<b>108.0%</b>	<b>6.0%</b>	<b>8.7%</b>	<b>14.9%</b>

Source: Oakwood Capital Management LLC, Charles Schwab, Bespoke Investment Group, LLC.

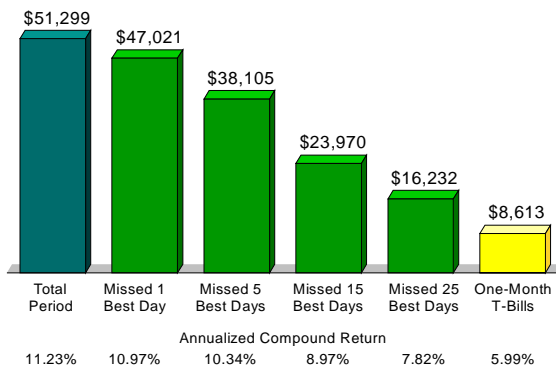
As previously stated, at its recent peak on August 16, 2007, the Volatility Index (VIX) was up 108% from 50 trading days earlier. Since 1990, there have been only six other periods of such intense short-term volatility. Each time, the S&P 500 was higher one, three and six months later. **History is not a perfect guide, but the table highlights the market's tendency to recover, at least in the short term, after volatility spikes.**

Movements in the financial markets may not always appear rational and prices may not always be "correct," but market forces are so competitive that it has yet to be demonstrated that any investor, or group of investors, can consistently profit at the expense of others or consistently outperform the market as a whole. The idea of market efficiency is widely acknowledged by financial professionals and academic researchers alike. Many studies have found that securities prices quickly reflect new information rendering market-beating strategies ineffective.

Some investors believe that they can increase returns, or reduce risk, by moving money into the stock market before it goes up, and out of the market before it goes down. This is commonly known as market timing. Variations of this approach include strategies such as sector rotation and tactical asset allocation. The common theme that ties these strategies together is the attempt to add value by forecasting future market movements, and then moving money to take advantage of this knowledge.

The chart below shows that the vast majority of the return for the

#### Performance of the S&P 500 Index Growth of \$1,000 January 1970 - December 2006

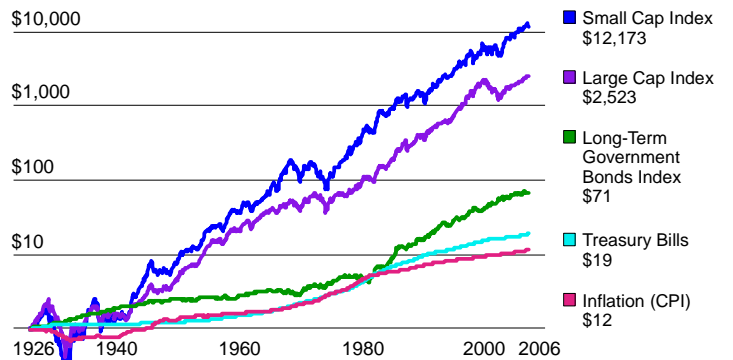


The S&P data are provided by Standard & Poor's Index Services Group. US bonds and bills data © Stocks™, Bonds, Bills, and Inflation Yearbook, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

S&P 500 Index is captured in a very small number of best-performing trading days. The return is significantly reduced without these best performing days. If an investor were to miss even a few of these days, it significantly reduces the return. This is why it is important to stay invested and stay disciplined.

Traditional active managers strive to beat the market by taking advantage of pricing "mistakes" and attempting to predict the future. Too often, this proves costly and futile. Predictions go awry and managers miss the strong returns that markets provide by holding the wrong stocks at the wrong time. Meanwhile, capital economies thrive—not because markets fail but because they succeed, as is evidenced by the following chart. ■

#### Long Term Picture of Growth of \$1 1926-2006



Source: Dimensional Fund Advisors, Oakwood Capital Management LLC

## Conservative, Moderate and Aggressive Equity, Balanced and Fixed Income

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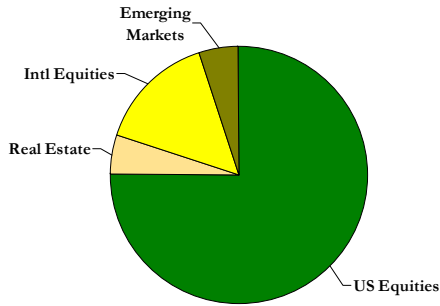
# STRUCTURED GLOBAL EQUITY STRATEGIES

Global equity markets ended the third quarter in positive territory. In the US, large cap growth stocks led the way. Industrial materials, telecommunication and hardware were the best performing sectors in the US, with consumer services, financial services and media being the US laggards.

International returns for US investors looked slightly better than US returns, and were aided by the relative weakness of the US dollar. In particular, international large cap stocks fared better than international large cap value stocks. Emerging markets and small capitalization stocks were, respectively, the best - and worst - performing asset classes in the third quarter.

**Oakwood Conservative Global Equity**

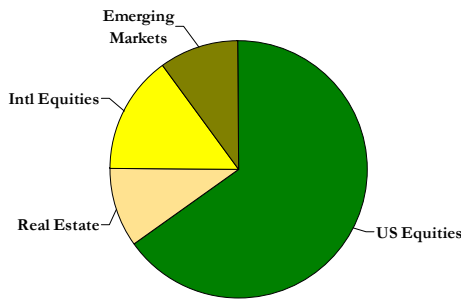
- Balance of value and growth as well as large, medium and small capitalization stocks
- Suitable for investors seeking income and long term capital appreciation



The Conservative Global Equity strategy posted a positive return for the third quarter of 2007. Its reduced exposure to smaller capitalization companies and its increased bias to US large capitalization companies aided its return. This strategy also benefited from its allocation to US real estate, and developed and emerging international markets.

**Oakwood Moderate Global Equity**

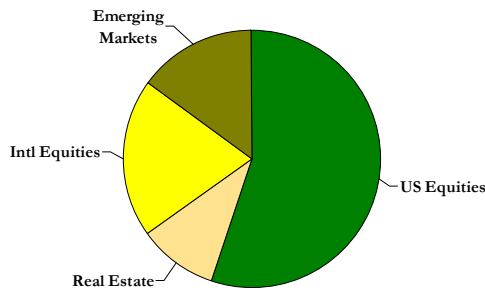
- Has an increased bias towards value by using multiple asset classes and greater emphasis on smaller capitalization stocks than the conservative strategy
- Suitable for investors seeking above average returns through long term capital appreciation



The Moderate Global Equity strategy had a positive return for the third quarter of 2007. Its exposure to developed and emerging international markets were positive contributors to the quarterly return. Its increased bias to smaller capitalization and international real estate slightly diminished returns for the quarter.

**Oakwood Aggressive Global Equity**

- Has a higher non-US companies component as well as a greater value tilt and emphasis on smaller capitalization stocks than the moderate strategy
- Suitable for investors with a higher tolerance for risk seeking higher returns through long term capital appreciation



The Aggressive Global Equity strategy had a slightly negative return for the third quarter of 2007. The increased exposure to developed and emerging international markets helped the quarterly return. The increased bias toward small capitalization, both on the domestic and international side, slightly diminished quarterly returns.

- What Helped Strategies for the Quarter:**
- Emerging Markets
  - Large Cap International
  - US Large Company
  - US Real Estate

- What Hurt Strategies for the Quarter:**
- International Small Cap
  - US Small Cap
  - US Large Cap Value
  - US Small Cap Value

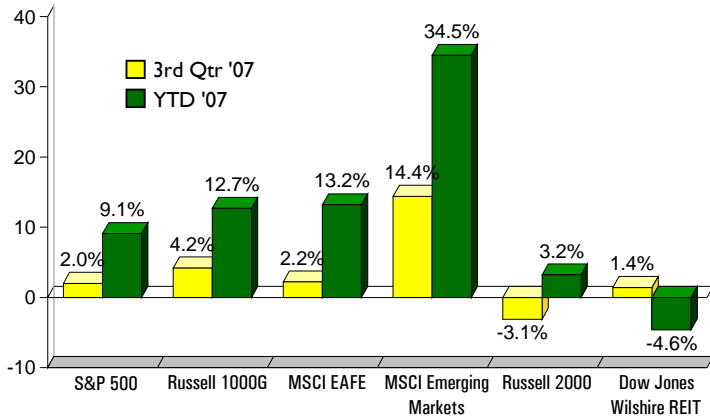


EQUITY INCOME & CAPITAL APPRECIATION STRATEGIES

In the third quarter of 2007, many investors reconsidered their investment in more speculative stocks, sending the prices of those securities down. This action, in large part, was due to volatility induced by subprime mortgage worries and a general real estate meltdown which occurred during the third quarter of 2007. Still, most of the major indices finished the quarter with respectable gains, with the exception of the Russell 2000 Index, a measure of smaller capitalization stocks, as seen below.

continue to be cautiously optimistic towards the US equity market, and therefore, we remain well diversified with no individual position over 4% of the portfolio at its cost. We continue to favor the following sectors: energy, telecom, industrials, healthcare, and consumer staples.

Equity Market Indices



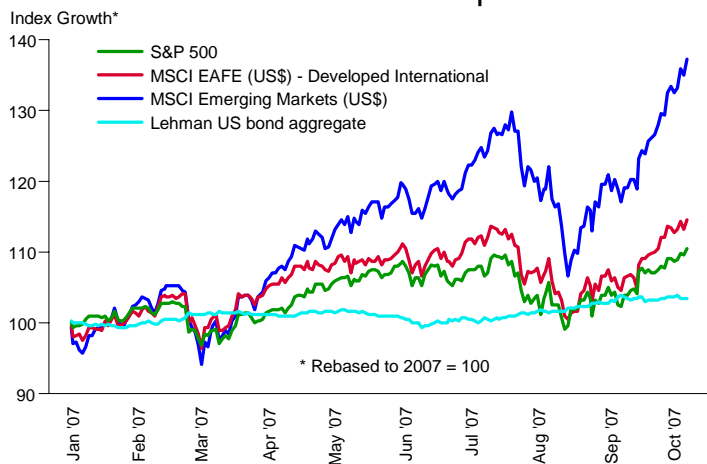
Source: Frank Russell Company, Standard & Poor's Index Service Group, MSCI data copyright MSCI 2005, Dow Jones Indexes, Oakwood Capital Management LLC

Amid a lull in the credit market turmoil, equity markets around the globe have recovered nicely from their mid-August 2007 lows. Central banks have injected hundreds of billions of dollars into the banking system, stabilizing the commercial paper market at the shortest maturities. And equity investors seem confident that continued Federal Reserve Board (Fed) rate cuts—following the weak labor report—will keep the economy on relatively sound footing.

We have been underweighted for some time in the financial sector, which has become more attractively valued. We are looking to add to this sector. Of particular interest are some high quality financial institutions which possess the investment characteristics we seek, that is, positive free cash flow, strong returns on capital, increasing dividends, and healthy earnings growth that trade at attractive valuations. We are patiently waiting for opportunities and will add to client portfolios when appropriate. Please note that Bank of New York (BK) completed the acquisition of Mellon Bank (MEL), a holding in many client portfolios, during the quarter, and we chose to keep the combined Bank of New York Mellon stock.

One of our technology holdings, First Data (FDC), was recently acquired by a private equity firm, and many of our clients have seen cash coming from this acquisition into their portfolio. We also recently added a new technology position to client portfolios, a firm whose financial record few from any industry can match. Sales in this company have grown from \$6 billion a decade ago to over \$50 billion in fiscal 2007, and returns on invested capital have averaged a staggering 55%. This company faces a number of challenges, but we think the stock is a lower risk investment, given the firm's dominant position in its major markets.

Stocks Resilient Despite Risks



Source: Datastream, Morgan Stanley Capital International, Lehman, Charles Schwab

We recently sold a successful investment, Suncor Energy (SU), a Calgary-based oil producer and refiner, due to a recent announcement by a Canadian review panel that it may introduce sweeping changes to Alberta's royalty regime. The panel reviewed the overall government take (royalties, taxes, leases) and concluded that Albertans do not get their fair share from the massive energy resources within their province. If enacted in its entirety, the proposal would have broad industry consequences, and we feel that there is too much risk exposure to continue holding this company. We therefore added a new company in the energy sector that is a leading provider of proprietary and patented services for the global petroleum industry. These services enable the Company's clients to optimize reservoir performance and maximize hydrocarbon recovery from their producing fields. ■

Our well diversified, high quality client portfolios were positioned to withstand the volatility during the quarter, generating very favorable quarterly and year-to-date returns. We



**FIXED INCOME STRATEGIES**

**Taxable Fixed Income Strategy**

September 18, 2007, marked the first time in over 3 years that the Fed altered its monetary policy stance, favoring lower interest rates and economic growth. In an accompanying statement, they cited concerns that rising defaults in sub prime loans are likely to have an adverse effect on other areas of the economy and the prospects for sustained economic growth. Naysayers of this policy change cite concerns that the Fed's rate cut will backfire and cause inflation to go higher and lead to a rise in Treasury yields. In fact, the first reaction to the Fed's rate decision was quite negative, with long Treasury bond prices plunging 5%. However, weakness in recent economic data was supportive of this decision and bond prices are now moving steadily higher again, thus yields are falling,

While there are a number of unsettling aspects that might prove negative to inflation, including stubbornly high commodity prices, the rapidly falling dollar and near record gold prices, actual inflation numbers are well behaved. In fact, the Fed's well watched Personal Consumption (PCE) Price Deflator fell below 2%, on a year over year basis.

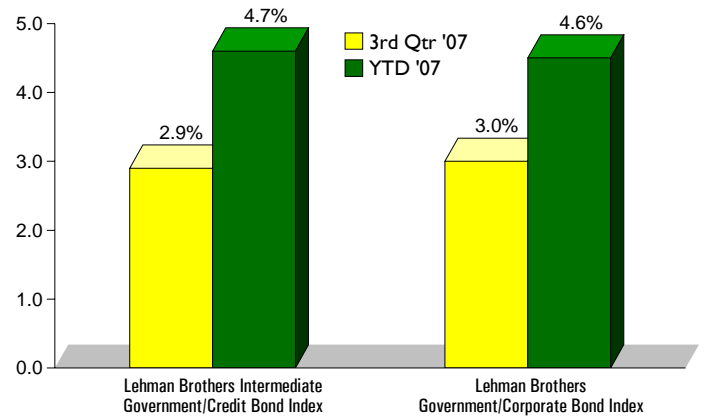
Our view remains one of cautious optimism. While we agree that the Fed needed to lower interest rates and may need further cuts in the months ahead, **we are monitoring employment data as a key variable to future changes in monetary policy and interest rates. For now, the recent weakness in employment data, coupled with the distressed housing market, should allay concerns about overstimulating the economy and a rekindling of inflation.**

As part of our management strategy, we recently increased our exposure to the corporate bond market, bringing us back to a neutral weighting versus respective benchmarks. The cheapening of yield spreads across virtually all sectors provides better valuations than have been available for some time. As an example, four months ago, Aaa rated General Electric Capital Corp was yielding only +58 basis points more than a comparable 5-year Treasury. Currently, the yield advantage is over +90 basis points. Another widely held security, Target Corporation, is presently yielding +100 basis points over comparable Treasuries. Even though we have a limited exposure to the financial sector, we may further reduce our exposure, in favor of industrial type companies. We are especially interested in those companies that have a strong presence in overseas economies. As our research progresses, we will keep you posted of our choices.

Finally, we will restrict investments in Federal Agency securities. We do not feel that Congress should use the Government sponsored Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation to bail out bad decisions in the mortgage industry. We do agree that they should continue to mandate sound lending practices and maintain high quality standards in their loan portfolios.

Another consideration leading to our decision to limit the use of Federal Agencies in client accounts is the potential impact on earn-

**Lehman Brothers Bond Indices**

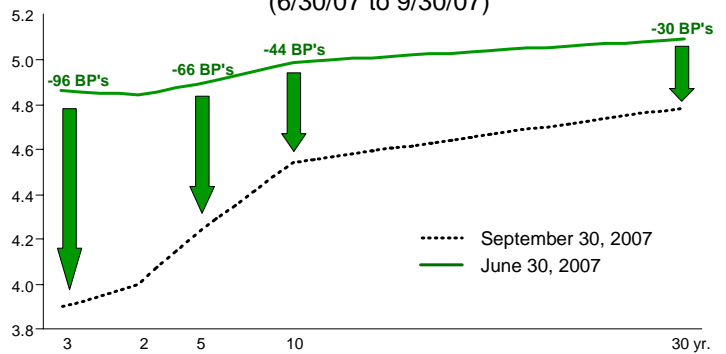


Source: Lehman Brothers, Oakwood Capital Management LLC

ings from reduced housing activity. As a protection, we will restrict new purchases to maturities of less than 4 years.

As seen below, the shape of the Treasury yield curve has changed significantly during the quarter.

**Quarterly Yield Change (6/30/07 to 9/30/07)**



Source: Bloomberg L.P., Oakwood Capital Management LLC

The most significant change shows up in the shorter maturity area, where yield declines approach 1%, or 100 basis points. This is the result of weakness in employment, housing activity and a directional change in monetary policy to pro-growth. It is interesting that long bond yields have also declined, although to a lesser degree, implying investors are confident that, over the long-term, inflation will remain under control. Now that short-term yields have declined more than long-term yields, the 2-year versus the 10-year yield spread has steepened to 65 basis points. This will provide banks and mortgage lenders some relief in their ability to borrow at a lower short-term rate, in order to fund longer term commitments.

**Unfortunately, consumers have seen little relief in their ability to borrow at a lower rate. This may be a vital factor to the future direction of the economy.** Recently, we used this steeper slope in yield spreads as an opportunity to extend 10-year positions, in favor of the U.S. Treasury 8.125% due August 2018, for generous yield gains.

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## FIXED INCOME STRATEGIES

Taxable Fixed Income Strategy  
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As time passes, this security should outperform as it reaches yield parity with its 10-year counterpart.

It is our goal to remain fully invested and as previously stated, monitor upcoming employment data for signs that the economy is rebounding too strongly. If this occurs, we stand ready to reduce longer positions and utilize cash as a buffer to potentially higher interest rates.

### Tax Exempt Fixed Income Strategy

**W**e expect the problems related to sub prime lending to have a negative effect on the economy and many municipalities for some time. As you know, there has been a barrage of new mortgage originations, based on below market teaser rates and absent the requirement of an appropriate down payment. This type of financing technique has helped to propel an unprecedented boom in housing and the economy. To sustain this phenomenon, interest rates would need to remain at abnormally low levels, or household income would need to grow at a comparable rate to the increase in mortgage costs that accompanies a rise in variable rates. In reality, throughout many areas of the country, household income has not kept pace with rising home prices and rising mortgage rates, thereby forecasting an end to the housing boom.

Unfortunately, now that mortgage rates have adjusted, a large number of these initial teaser rates are readjusting beyond the affordability of many home owners. This situation can effectively reduce the market value of all homes, as repossessions and the glut of unsold homes mount. There appears to be no quick fix to this problem, even though the Federal Reserve recently lowered its benchmark Federal Funds lending rate by 50 basis points to 4.75%. Adding to the dilemma, mortgage lenders are now being forced to apply stricter standards prior to mortgage approvals. These include mandatory down payments and more stringent affordability requirements.

Meanwhile, moderating home values and accelerating foreclosures could be damaging for many local level municipalities, who are largely dependent on the collection of property taxes, in order to maintain services to the community. **At Oakwood, we meet this challenge by only investing in well-managed towns or cities that exercise sound management practices and are able to operate with a dependable income base. This is essential to the servicing of its debt structure, which is vital to our clients. In addition, we continue to seek out tax-free bonds based on essential services such as water or sewers, surcharges attached to voter approved propositions or other reliable user fees to support bond payments. Historically, the backing of these types of securities has been somewhat immune to changes in the economy.**

A difficulty facing State level municipalities is the potential impact that housing deflation has on consumer confidence and a state's ability to garner revenue through the collection of sales taxes. We believe that some states, including California, have adopted reckless spending

**However, if our long-term forecast is correct, interest rates may need to move much lower to salvage the housing market and the economy.** In the past, economic and market "bubbles" included a collapse of the Japanese stock market, huge declines in technology stocks and commodity price deflation. Situations like these are not usually resolved overnight. It is unlikely that our current housing problems will be an exception. Even with additional help from the Fed and a further decline in interest rates the impact to the economy may be felt for some time. ■

programs with expectations that sales tax revenues would continue at a record pace. With clear signs that the economy is beginning to slow, it is likely that tax revenues will also slow. In Massachusetts alone, experts suggest it must spend at least \$2.2 billion to improve structurally deficient bridges. According to a recent report, they are falling into disrepair faster than they can be fixed. The State needs to spend an additional \$19 billion over the next 20 years, just to maintain its transportation infrastructure. Unfortunately, a slowing economy will not help this situation. **As a result, we are restricting the use of State level obligations, especially in California, unless they are backed by Government collateral or are insured, and have a maturity within 5 years.** As stated repeatedly in previous Outlooks, we have always required a minimum underlying quality rating of A2 with added insurance enhancement, for an overall rating of Aaa. For an uninsured investment to receive our approval, the security must maintain a minimum Aa quality rating.

**Despite the challenges that lay ahead, we feel municipal yield levels are attractive and reflect many of these concerns. If our interest rate forecast is correct, yields may need to fall much further, in order to rekindle GDP growth back to 3 to 4%.** This, combined with actions already taken by the Federal Reserve, should begin to stabilize both the economy and housing. With tax-free versus taxable yield ratios in the 81% to 89% range, we are adding to positions in the 5 to 10 year maturity areas. We remain mindful that the Federal Reserve will adjust its policy in response to upcoming data. We also stand ready to adjust our forecast and portfolio positioning, in response to changes in the economy, taxing policies and inflation data. For now, we will remain fully invested with a duration target of 5.2. This should be conservative enough to protect us against unforeseen events, yet suitable for market appreciation resulting from an expected decline in yields. ■



**RESEARCH UPDATE**

**Real Estate Investment Trusts (REITs) - A Truly Global Asset Class**

Equity REITs are companies that own and often manage income-producing real estate properties, such as hotels, office buildings, apartments and shopping centers. To qualify as a REIT, a company must meet, among others, the following two requirements. First, it must invest at least 75% of its assets in real estate. In addition, it must derive at least 75% of its income from real estate property or interest on real estate financing. All of Oakwood's Global Equity Strategies have an allocation to REITs: The Conservative Global Equity Strategy invests in US REITs, and the Moderate and Aggressive Global Equity Strategies have an allocation to both the US and International REIT markets.

REITs have independent risk and return characteristics that make them a separate asset class, one that is characterized by low sensitivity to market movements and significant exposure to size and value risk factors. An advantage of REITs, when compared to direct investments in real estate, is that they make it easier for investors to have a well-diversified allocation to the real estate asset class, both in terms of the types of properties and the locations of those properties, because they are cheaper to buy and sell than real estate, and do

not have the same liquidity constraints as a direct investment in real estate.

The table below displays the return and standard deviation (a statistic describing volatility, the higher the percentage, the higher the volatility) for US REITs, the S&P 500 Index, the large cap Russell 1000 Value Index, and the Russell 2000 Index, which is an index that tracks the small cap universe. As you can see, REITs have displayed superior returns over the other indices, with lower volatility, except for the volatility of the Russell 1000 Value Index.

<b>Summary Statistics for Asset Class Indices</b>				
<b>Compound Return and Standard Deviation</b>				
<b>January 1979-December 2006</b>				
	<b>Equity REIT Index</b>	<b>S&amp;P 500 Index</b>	<b>Russell 1000 Value Index</b>	<b>Russell 2000 Index</b>
<b>Compound Return</b>	15.53%	13.47%	14.60%	13.30%
<b>Standard Deviation</b>	15.04%	15.53%	13.55%	18.47%

The global market for publicly traded real estate securities has grown substantially in recent years. For decades, publicly traded REITs

or REIT-like structures were mainly available in the United States and Australia. But, as more developed countries and even some developing countries have adopted REITs or REIT-like structures to encourage investment in commercial real estate, and as investors have continued to appreciate the benefits of investing in publicly traded real estate equities, we have seen, in this decade, the emergence of a truly global real estate asset class. ■

*We hope that you all enjoy the rest that Fall has to offer, and best wishes for a meaningful holiday season. In the meantime, we invite you to call us if you have any questions about your wealth management plans. We look forward to talking to you.*

*Oakwood Capital Management LLC*