AUBRY & EUSTICE

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"There is a time when we must firmly choose the course we will follow, or the relentless drift of events will make the decisions."

- Herbert V. Prochnow

"[W]e can all have more money . . . [but] money doesn't buy happiness. It rents it."

- P.J. O'Rourke

What do we do now?

On Wednesday, July 2, the Standard and Poor's 500 stock index (S&P 500) briefly slipped into official "bear market" territory. A "bear market" is officially defined as a 20% drop off of an index's most recent peak. The S&P 500's most recent peak (the all-time high water mark) was 1,565.15 on October 9, 2007. The intraday low on July 2 was 1,252.0; the S&P 500 closed that day at 1,261.52. As of the writing of this article, the S&P was about 1240.

From a year-to-date perspective, the S&P 500 has shown a -11.91% return and a -13.12% return over the past year (July 1, 2007 through June 30, 2008). The EAFE Index has posted a -10.58% return over the past six months and a -10.15% return over the past year (July 1, 2007 through June 30, 2008).

The price of a barrel of oil is near an all-time high and it now costs over $4.00 for a gallon of gasoline, with some places in the United States topping $5.00. Stalwart American companies have stock prices that are at 54-year lows (General Motors), have almost gone bankrupt (Bear Stearns), have moved jobs overseas (what company has not) or are so seemingly unstable—companies like Leman, Fannie Mae and Freddie Mac—the American economy (and stock market) seems to be sliding ever-haplessly into deeper and darker despair.

If that's not enough, we are in an election year and every politician seems to be falling all over themselves to promise whatever they need to promise in order to get elected (or re-elected), except coming up with an energy policy (more on this later in this Newsletter—see page 5 "Not an Oil Crisis—It's a Political Crises").

So what does this mean to investors?

The frustrations that people have with the stock markets are based, primarily (if not solely), in emotion. It was the late 1990s that we, as a society, began to develop into an "investor class." This was just in time for (or the cause of) the great market bubble, and then crash, of 2000 and then decline through the first quarter of 2003. Because of this, we remember the frustrations of watching our portfolios drop – sometimes precipitously. While the focus of this newsletter article is not on the psychology behind the investment decisions during that time period, it is the focus of this newsletter article is to bring to light the importance of understanding how to become a successful long-term investor. This includes those of us who have just started investing and those of us who derive the vast majority (if not all) of our income from our investments.

The vast majority of Americans are relatively new investors, In fact, an overwhelming majority of Americans have only been part of the "investor class" since about 1998. Yes, quite a few Americans have been investing for some time; however, they only recently moved into the "investor class". Given this, most do not know what to do when situations arise like the one we are currently are in now. And while the financial markets seem to currently be in dramatic tumult and chaos, it is possible, however, to have order in this confusing time if one understands the Math; Math provides the basis of understanding for all things.

The study of Math leads us to the study of Statistics. When Statistics is studied, one learns about something called "***reversion to the mean***." Technically speaking, reversion to the mean is "the statistical phenomenon stating that the greater the deviation of a random variate from its mean, the greater the probability that the next measured variate will deviate less far." (www.mathworld.wolfram.com/reversiontothemean.html) Or simply, "what goes up is likely to come down, and what goes down is likely to come back up." That is, everything goes back to the average.

For example, let's assume that Carl, Ed and Tom are all standing in a backyard swimming pool. Each has a basketball (the basketballs are equal—let's assume they are Spaldings). Carl throws his basketball up into the air; Ed allows is basketball to remain in its "natural" state and rest on top of the water; Tom pushes his basketball deep into the water.

What happens next? Carl's basketball is going to come crashing down and will likely (depending upon how high he threw his basketball) go under water. It will then come back to the top of the water and eventually, if left alone, will come to rest in its "natural" state—on top of the water.

Tom's basketball, unless it has a gaping hole in it, will likely come shooting back out of the water; how high depends upon how deep in the water the basketball was. The basketball, if left alone, will eventually come to rest in its "natural" state—on top of the water.

Ed's basketball, while not immediately affected, but because of the actions Carl's and Tom's basketball, likely had some sort of movement. It may have been slightly sucked under water because of Tom's basketball creating a bit of a vacuum or it was likely bounced out of the water when Carl's basketball came crashing into the water. If left alone, Ed's basketball will eventually come to rest in its "natural" state—on top of the water.

While a corny and simplistic example, this accurately explains "reversion to the mean." The basketballs, no matter if they were thrown up, pushed down or left alone, eventually all ended up in an average state.

"OK, thanks for the statistics lesson, Mark. But what does this mean to me?" you may be asking yourself. Stocks are no different. While quite a bit more complicated, stocks are "thrown" up or "pushed" down by a variety of different factors. But the history and the science behind the capital markets shows us that there is ***reversion to the mean***. Using and understanding the principal of "***reversion to the mean"*** shows us how getting "average" returns is the way to great portfolio returns.

What does this mean to us now?

Let's go back to Carl, Ed and Tom in the backyard swimming pool. But instead of just the three of them, there are now 14,997 other people, all with basketballs, in the pool with them. Now assume that 14,750 of the people are pushing their basketballs down into the pool, while the remaining 250 are throwing their basketballs up. That is essentially what is happening right now with the stock market (figuratively speaking). Very soon those 14,750 basketball are going to come shooting out of the pool. It is not a far leap to now assume that the basketballs are stocks. You own a piece of all 15,000 stocks. Some are going to come shooting out of the water with great force, some will pop up and a few (the ones with the holes) may not come out of the water at all. Do you want to sell them now? Which ones do you sell? Which ones do you keep? If you sell, when do you buy again?

I asked similar questions to someone recently who, driven by fear, was trying to convince me that it was the right time to sell out of his positions and move everything to cash. He snorted, "It's your job to know when to get in and out of the market." I quickly responded, "So, you want me to look into my crystal ball and predict the future then?" We rely on our weather persons for information about the upcoming weather conditions, but they can't predict the weather with a high degree of accuracy over the next several days. So it is with investment professionals, fund managers, and stock brokers when thinking in terms of what individual investments will do. In fact, it is much easier to "predict" the weather than it is to "predict" the direction of the financial markets. We know that every 3-4 months, the basic weather will change. We know that the financial markets will go up and down, but we don't know when. We do know, however, that given enough time, the markets will generally be higher in the future.

What should an Investor do now?

1. Invest for the future, not the present

2. Diversify

3. Be patient

"Diversification is the closest thing to a free lunch . . . you might as well eat a lot of it."

If we look at the returns of the S&P 500 during arbitrarily chosen time periods over the past 38 years, we see several things:

1. The S&P 500 has positive returns in every 10-yr period
2. Over the past 38 years, there are 30 positive years and only 8 negative years
3. Three (3) of those 8 years have been in this decade.

Let's look at the S&P 500 performance over each of the last four decades:

1970s	5.86%
1980s	17.55%
1990s	18.21%
2000s (thru 2007)	1.66%
1970 – 2007	11.07%

Are the poor returns of the 2000s just a ***reversion to the mean***?

While every decade has a positive return, the decade of the 2000s is close to being the first negative decade since the 1930s (1/2000 – 6/2008 is 0.06%; during the 1930s, the return of the S&P 500 was -0.05%).

So, what is an investor to do? The first thing an investor needs to do is have an investment philosophy. The second thing: an investment strategy, built on a scientific, fact-based philosophy; the third thing is patience, to allow the strategy to work.

1. Have an Investment Philosophy – determine what is it that you *believe* about the stock market
2. Develop an Investment Strategy – the practical application of what you believe about the stock market.
3. Patience—Let the strategy work.

Everyone knows that we *should* diversify, but few understand ***why*** we diversify. Kenneth French's statement that *"diversification is the closest thing to a free lunch . . . you might as well eat a lot"* is important for two reasons: 1. diversification enhances returns and 2. diversification decreases volatility.

If we build a portfolio made up of the S&P 500 at 50% and the EAFE index at 50%, the returns would have looked like this:

1970s	8.23%
1980s	20.53%
1990s	12.86%
2000s (thru 2007)	3.72%
1970 – 2007	11.57%

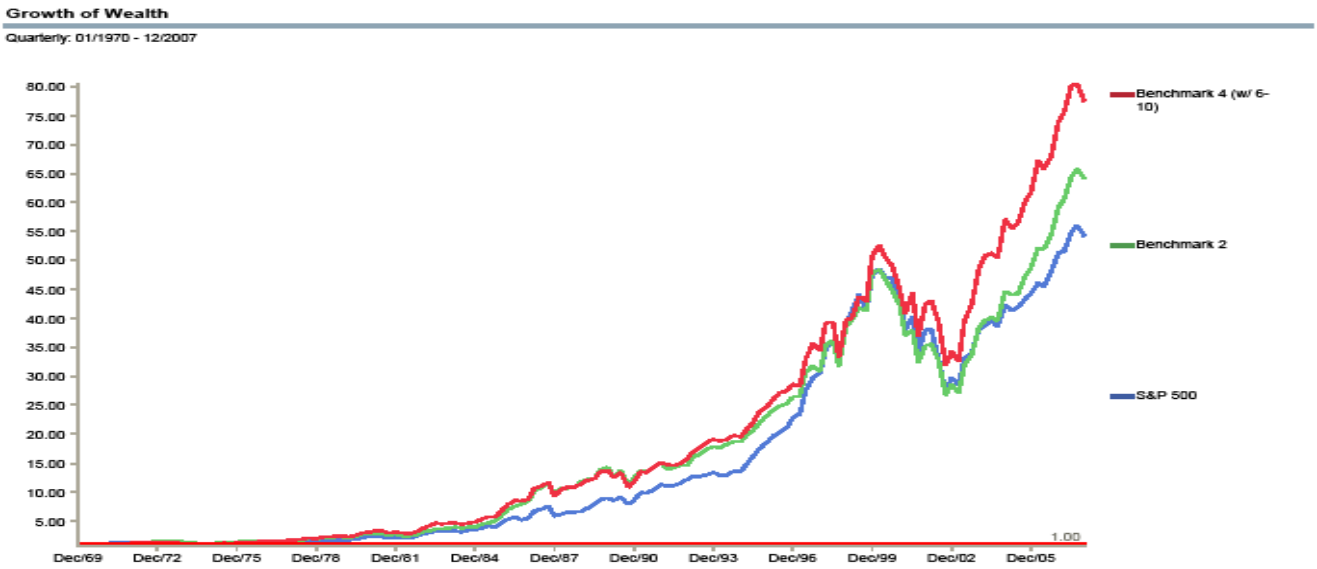
Lastly, because both the S&P 500 and the EAFE track Large Cap companies, let's see what would have if we added Small Cap companies, as tracked by the CRSP 6-10 index:

1970s	9.26%
1980s	18.90%
1990s	13.99%
2000s (thru 2007)	5.44%
1970 – 2007	12.13%

When one compares the numbers, at first there does not seem to be that much of a difference. From 1970 thru 2007, the numbers look like this:

S&P 500 (100%)	11.07%
S&P 500/EAFE (50% each)	11.57%
S&P 500 (34%)/EAFE (33%)/CRSP 6-10 (33%)	12.13%

At first glance, a 1.06% difference in each of the 38 years does not seem like a big difference. But when the numbers are crunched and put into dollars, there is a dramatic difference. $100,000 at 11.07% turns into about $5,411,700. However, $100,000 at 12.13% turns into $7,742,650. To spare you from having to pull out the calculator, that is a $2,330,880 difference. The graph below shows, in color, the aforementioned portfolios since 1970. The blue represents the S&P 500. The green represents the S&P 500 and the EAFE, each at 50%. The red represents the S&P 500 at 34%, the EAFE at 33% and the CRSP 6-10 at 33%. It clearly pays to stick to an investment strategy that strongly believes in diversification.



See Standardized Performance Data & Disclosures.
Selection of funds, indices and time periods presented chosen by client s advisor. Indices are not available for direct investment and performance does not reflect expenses of an actual portfolio. Past performance is not a guarantee of future results. Graph represents a hypothetical investment of $1. Performance includes reinvestment of dividends and capital gains.

That's great, but what do I do now?

Make sure you know what it is you believe. That is, know what your investment philosophy is. Implement that philosophy with an investment strategy that understands both diversification and the science of the capital markets. Lastly, be patient and stop watching TV and stop reading the financial "self-help" magazines.

When asked what his favorite time period for holding investments, the great Warren Buffet replied with a resounding, "Forever." Mr. Buffet is also famous for saying that you can't make investment decisions "with a weather vane." In other words, it is not wise to make strategy (or even philosophical) decisions when the markets are at peaks or in the doldrums. There is just too much emotion involved.

If you have Aubry & Eustice managing your investments, it is important to remember that your portfolio is built with the future in mind. Portfolios are built with an understanding of the science of the capital markets and, therefore, on the principles of diversification. It is very important to not have your head "buried in the sand;" however, it is more important to have faith in the future. And it is easy to have faith in the future when you know what it is that you believe.

1. Invest for the future, not the present
2. Diversify
3. Be Patient

Not an Oil Crisis—It's a Political Crisis

"Illigitimi non carborundum" — Do not let the illegitimates wear you down.

It is safe to say that we do not care much for politicians. We have a special disdain for ***career politicians*** (those politicians who have been in Washington, D.C. for more than two terms in any one position.) Career politicians have one main objective: to get re-elected. The fulfillment of their campaign promises to their constituents always seem to come after the fulfillment of promises to other politicians (if at all).

Supply vs. Demand

Most agree that the current energy "crisis" is being caused by issues of supply and demand. (The conspiracy theorists and ignorant politicians speculate – pun intended – that it is the speculators that are raising the price of oil.) However, many disagree as to which, supply or demand, should be blamed for the cause of the most recent, media-driven "crisis". (There are no gas lines and gas stations are not running out of gas—at least not yet—so we do not see it as a "crisis" as the media is portraying the current market conditions.)

Here is a brief description of the two opposing sides in the oil debate:

"Supply-siders" believe, among other things, that if there were an increase in the supply of oil—or if the markets believe there will be new supplies entering the marketplace in the future, the cost of oil, and therefore, gasoline, would drop precipitously. Therefore, those individuals who believe in this theory, would like to see the oil companies allowed the opportunity to drill for oil in places like Alaska, Colorado, Montana, North Dakota and off the coast of many states.

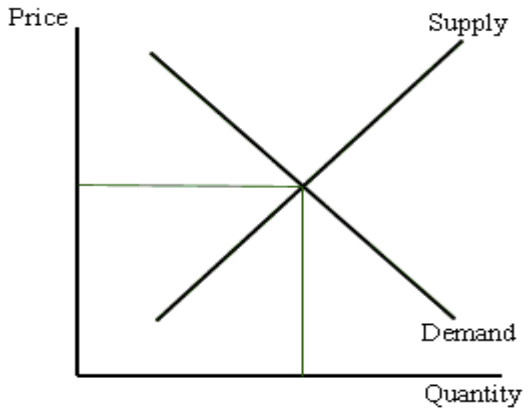


Figure 1.

"Demand-siders" believe that if there were a decrease in the demand for oil, this would drop the price, if not reduce the need to use the carbon-based product to fuel our economy, homes, businesses and vehicles. The individuals who believe in this theory support research, subsidies and grants for the use of alternative energy sources such as solar and wind energy, thus reducing, if not eliminating the need for oil.

While this is a very basic explanation of "supply-side" and "demand-side" economics, it really provides the two opposing views that are having a "tug-of-war" during this current economic situation. While we will not share our personal opinions as to which "side" we prefer, it is evident that what the United States truly needs to do is to develop a clear, concise and easy to follow and implement ***Energy Policy***.

Whether it becomes the Energy Policy to drill for more oil or to seek alternative energy sources, or a combination of both, something needs to be decided – and soon. What is most unfortunate for the American people is that this is an election year and politicians are making promises to get re-elected. (You don't think the boys at OPEC are aware of this?) The American public is paying high prices for gasoline because the politicians in Washington, D.C. do not have the moral courage to make a decision. And yet, the stock markets continue to decline.

Fortunately, the US is not currently in the midst of an energy crisis; unfortunately, we are in the midst of a political crisis.

Portfolio Performance (as of June 30, 2008)

Indices	YTD	1 Month	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
S&P 500	-11.91	-8.43	-2.72	-11.91	-13.12	4.41	7.58	2.88
EAFE	-10.58	-8.16	-1.93	-10.58	-10.15	13.34	17.16	6.23
Standard Portfolios								
AFG 97	-11.62	-9.59	-3.51	-11.62	-14.48	10.75	17.43	11.53
AFG 88	-10.43	-8.72	-3.09	-10.43	-12.93	10.25	16.16	10.97
AFG 75	-8.9	-7.47	-2.79	-8.9	-10.65	9.39	14.27	10.2
AFG 50	-5.77	-4.95	-2.04	-5.77	-6.22	7.54	10.48	8.41
AFG 25	-2.5	-2.35	-1.12	-2.5	-1.53	5.7	6.63	6.37
International-tilt Portfolios								
AFG 97 Int'l	-12.35	-9.87	-4.27	-12.35	-12.68	15.06	21.29	13.57
AFG 88 Int'l	-11.1	-8.97	-3.79	-11.1	-11.23	14.02	19.5	12.73
AFG 75 Int'l	-9.46	-7.66	-3.37	-9.46	-9.32	12.56	17.04	11.66
AFG 50 Int'l	-6.19	-5.09	-2.46	-6.19	-5.29	9.83	12.37	9.43
Global Equity								
GE 100	-10.4	-8.92	-2.5	-10.4	-14.38	7.12	N/A	N/A
GE 80	-8.09	-7.07	-1.88	-8.09	-10.81	6.51	N/A	N/A
GE 60	-5.75	-5.18	-1.27	-5.75	-7.15	5.84	N/A	N/A
GE 40	-3.83	-3.63	-0.89	-3.83	-4.07	5.16	N/A	N/A

Disclosures

Performance data shown represents past performance. Past performance is no guarantee of future results and current performance may be higher or lower than the performance shown. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. As with any investment strategy, there is a potential for profit as well as the possibility for loss. The investment strategies used by Aubry & Eustice, LLC are based on the hybridization of the Modern Portfolio Theory, the Efficient Market Hypothesis and the French/Fama Three-Factor Model. These strategies constitute Structured Asset Management with an emphasis on diversity in order to reduce risk.

The Aubry & Eustice, LLC portfolios are designed based on statistically relevant historical performance data for broad asset classes. These portfolios represent assets to be invested and allocated in numerous asset classes as determined by academic and scientific research. The data shown represents model portfolios constructed by Aubry & Eustice, LLC utilizing mutual funds. However, specific investor objectives and situations may warrant the utilization of alternative investments due to issues of taxability, or cost associated with diversification, and/or for other reasons as determined by Aubry & Eustice, LLC. The performance information presented in these charts, graphs and tables represent the average annual and/or average monthly returns for specific model portfolios. Data prior to July of 2005 represents back-tested performance figures for each portfolio based on actual mutual fund data. The back-tested and model performance figures assume the reinvestment of dividends and capital gains.

The performance shown is "gross performance," which includes the reinvestment of dividends and other earnings but does not reflect the deduction of investment advisors fees and other expenses. A client's investment returns will be reduced by the advisory fees and other expenses it may incur in the management of its advisory account. The advisory fees can be obtained by contacting Aubry & Eustice, LLC. Aubry & Eustice, LLC is not paid any form of compensation or commission from any mutual fund company or broker-dealer. Therefore, our selection and use of underlying assets is based solely on that asset's ability to best meet client objectives. Back testing and model performances have certain limitations and do not reflect an actual individual client's performance. Actual client accounts may vary significantly from the model performances due to factors unique to each client. The performance figures do not take into consideration significant economic or market conditions, rebalancing costs, cash flows, actual trading, transaction costs, all of which, when deducted, would reduce returns. For all data periods, performance figures and standard deviations calculated by utilizing information provided by Dimensional Fund Advisors, Standard & Poor's Index Services, Morningstar, the CRSP database, the MSCI database and other internet-based securities databases. All indices have certain limitations.

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