



AFG May 2008 Style Sector Book

May 1, 2008

Bismarck famously said, "Laws are like sausages, it's better not to see them made". During April, the thought could easily be extended to the political process as spectacles abounded. The Olympic torch relay was disrupted in San Francisco. Hillary Clinton won a big victory in Pennsylvania's Democratic primary, posing as Annie Oakley. John McCain went dancing in Selma. Barack Obama's former pastor Jeremiah Wright continued his magical mystery tour. Meanwhile, Barack Obama decided he can now disown the pastor after Reverend Wright's latest comments implied Barack was well aware of his prior ranting. All in all, it was a month of presidential election year politics that makes the US the envy of the vast majority of the world's population. While this took place, Wall Street in its typical manic fashion could only focus on bad news and the gloom that lies ahead. Lets recap some of these issues:

Bernanke started the month acknowledging a recession is possible this year. But, he also offered that, he expects the economy to rebound slowly in the second half of 2008, as the impact of lower interest rates and the recently passed incumbent re-election employment act, or otherwise known as stimulus legislation takes hold in the economy. In fairness to the Wall Street crowd, April's economic indicators provided little reason for cheer, as virtually all-key economic statistics were disappointing. We saw oil futures for June surged above \$120 a barrel, consumer confidence plunged to its lowest reading in 26 years according to the University of Michigan's consumer sentiment index, and March sales of new homes plunged to the lowest level in 16 1/2 years. The unemployment rate jumped to 5.1%, and as of last Friday, constituents of the S&P 500 Index, which had reported their financial results showed first quarter earnings that contracted by 14% in the first three months of the year. To make things worse, news headlines told us Costco and Sam's Club started rationing rice at some of its stores due to customer hoarding. The U.S. is dealing with the worst food inflation in more than a decade, and the US Department of Culture expects food prices to rise as much as 4.5% in 2008, on top of the 4% rise in 2007, compared to the 2.5% average growth in the past 15 years. Some politicians such as Kay Bailey Hutchinson are calling for the government to re-evaluate its corn ethanol welfare plan and pursue an alternative energy plan that makes economic sense.

In general, it is amazing how markets work. In spite of rapidly rising gas and food prices, the economy managed to grow 0.6% for the first quarter. While such growth is certainly anemic and below our long-term potential as a nation, listening to many politicians, you would think the US was on the verge of a 1930's era depression. Fortunately, we do see some lights at the end of the tunnel. The liquidity crunch that resulted in the overnight demise of Bear Stearns in March appears to be retreating in April. US financial firms raised approximately \$30 billion in new capital over the past weeks, suggesting investors have confidence that today's prices reflect much of the damage caused by mortgage related assets and leveraged loans.

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Both Merrill and Lehman sold more preferred shares in the month than they initially planned due to heavy demand. If the Fed is going to pause cutting rates in the rest of 2008, the US \$ should appreciate, which should in turn alleviate inflation pressure on gas and food. Economic cycles come and go, but what is important, in our mind, is to vigorously defend and improve the foundations of individual economic freedom the country has cherished for hundreds of years, which has produced the most vibrant and wealthy economy the world has ever witnessed. As a case in point, let us return to the rice rationing mentioned above by Costco. Costco pursued this action upon its own free will, because it understands it is in the company's best economic interest to ensure a wide base of customers can shop there and buy rice. In the Philippines, the government issued a warning to its citizens, that anyone caught hoarding rice will be prosecuted and put in jail. Thankfully the US allows markets, rather than bureaucrats to set allocations.

We just published a research report on *AFG Value Expectation on S&P500*. Some of our findings include: As of April 28, 2008, 37% of the S&P 500 companies have "negative" Sales Growth priced-into their current market valuations; 65% of the S&P 500 companies have Sales Growth expectations that are below their 5-year historical median; and the median company in the S&P 500 has just 3% sales growth priced-in. We continue to believe there are abundant opportunities for investing in the US equity market by focusing on stock picks, and, of course, AFG will be on your side assisting you in that endeavor.

From March 28 to April 25, 2008, the returns are the following:

20 Day Return (%)			
AFG Universe	4.40		
Large Growth	8.19	Energy&Extraction	9.96
Large	7.79	Basic Materials	7.99
Large Value	7.08	Capital Goods	7.48
Growth	5.54	Utilities	6.45
Mid Growth	4.69	Technology	5.74
Mid	4.19	Consumer Services	3.47
Mid Value	3.62	Health	3.44
Value	3.24	Consumer Durable	3.20
Small Growth	2.48	Consumer Non Durable	1.53
Small	1.55	Financials	1.43
Small Value	1.06	Transportation	1.38

Regards,

AFG Research Team

www.EconomicMargin.com



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