

Southern Capital Perspective

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2007 - A VOLATILE CHALLENGING YEAR

By Terry Nager

This past year saw many investors opening their monthly statements with great trepidation because of the increased level of market volatility. It was a year that, in terms of the market as defined by the S&P 500, produced only about half of its long-term average annual returns. However, we are pleased to report that Southern Capital Services was able to provide a substantially higher return that was more in line with our long-term average. Nevertheless, all of the volatility caused us to reassess our function and to re-evaluate our performance.

What are Southern Capital's Most Important Functions?

Our client's hire us to increase their wealth by investing the assets that they entrust to our management without exposing them to excessive risk. In order to perform this important task, we in effect "hire" what we feel are some of the most accomplished portfolio managers in the world. Since these individuals or teams manage mutual funds, it is easier to gather data about them and their performance records because so much public information is required for funds. This information enables us to evaluate how they have fared against their peers and industry benchmarks both in the bull, or up, markets as well as when the market is in the paws of the grizzly (bear, or down, markets).

A fund that soars in good times but gets destroyed in down markets will lose the battle of long-term compounded annual returns to the consistent performer whose numbers may not be as exciting in the strong up-moves. Always remember: when an investor purchases a mutual fund, the only thing that he or she is really buying is the management and their demonstrated ability to perform as evidenced by the track record. Their existing portfolio can be altered or totally changed anytime that the markets are open.

Outside of selecting the individual managers or management teams via the mutual funds, the other aspect of service to our clients is assembling the overall structure of the portfolio. If we ignored this aspect we might find seven or eight funds that met our criteria for outstanding management but they might all be in one sector of the investment universe, e.g. small company growth funds. This would result in a portfolio that was not diversified and subject to great jeopardy if that one sector fell out of favor. Therefore, we endeavor to construct our portfolios with diversification in mind and then seek out the superior managers in the various categories.

How Well Did Southern Capital Perform Its Dual Functions in 2007?

Over 90% of the primary component funds of our client portfolios outperformed the S&P 500 Index and most of them had double-digit positive percentage returns. The one significant fund that did not was in the large-cap value category, and we steadily reduced the position from around 25% of assets at the beginning of the year to around 6% at the close of 2007. Therefore, it is evident that our fund managers did a commendable job which enabled SCS to provide a good return for our clients.

The two tables depict the 4 largest fund positions in our portfolios representing about 65% of assets under management. The first table shows the 2007 calendar performance for the four funds and the S&P 500 (Please note fund #1 had an extremely high return for the year. However we only began buying into this fund during the second half of the year and therefore only participated in part of the year's return). The second table shows how those same funds performed during the 2000-2002 bear market, again compared with the S&P 500. The funds are labeled 1-4 and upon request we will provide the names of the funds and the supporting documentation.

Table 1 2006 Fund	1 Year Comparison Return %
Fund 1	79.95%
Fund 2	10.18%
Fund 3	11.32%
Fund 4	17.37%
S&P 500	5.49%

Table 2 Bear Market Comparison	2000-2002 Cumulative Return	Annualized Return
Fund 1	86.84%	23.17%
Fund 2	33.30%	10.0%
Fund 3	3.64%	1.20%
Fund 4	13.26%	4.24%
S&P 500	-37.61%	-14.55%

The second aspect of the dual function was fulfilled by the fact that our client portfolios had funds that represented small company funds, mid-caps, large caps, international, domestic, growth-type, value-type, as well as world allocation, which incorporates almost all of the above. The answer as to the performance of our dual functions in 2007 was positive and we were generally pleased except for the fact that we always feel that it could have been even better. However, all of that is history and now we look at 2008 rising with all of its uncertainties and potential turbulence.

2008 - WHAT DOES THE FUTURE HOLD?

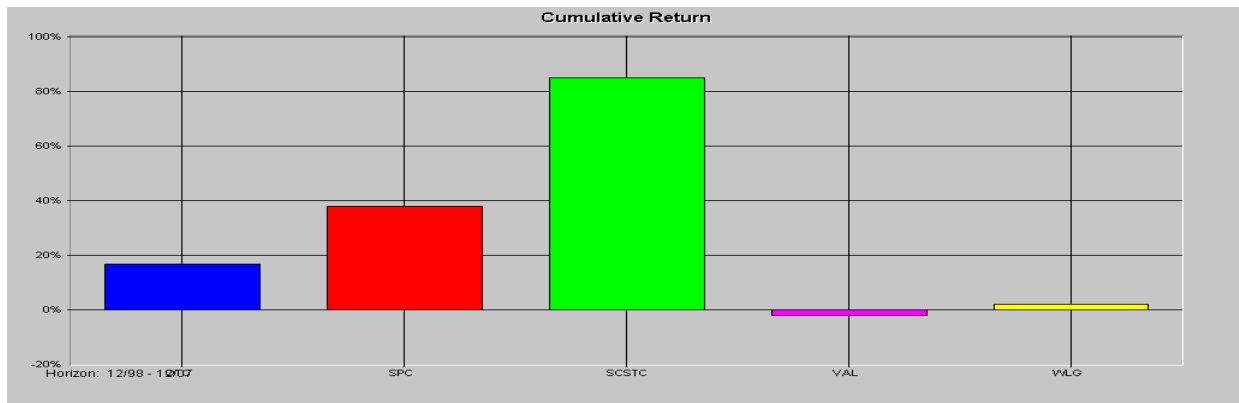
Thus far 2008 is making 2007 look like a year of stability with minimal volatility. As this letter is being written the market is already down by about 5% and we haven't even had two complete weeks of the year. Should we panic and revert to a very defensive position as in 2002? I don't believe that would be the proper course of action at this time because many of the factors are very different today. For example:

- 1) The FED is aware of the problem and has indicated it is prepared to act aggressively
- 2) It is an election year and both parties will be looking for ways to solve the economy's problems even if these "solutions" are of questionable merit.
- 3) Corporate balance sheets are generally in good shape.
- 4) Price to earnings ratios (PE) are slightly below long-term averages and not what is usually seen at market tops.
- 5) There are market actions like Bank of America taking over troubled mortgage lender Countrywide Credit as a part of the solution to the mortgage problem and credit squeeze.
- 6) There are also proposed government actions to solve the mortgage mess and credit squeeze.
- 7) The global economy remains pretty strong in spite of showing some signs of slowing.

These are some of the factors that indicate to me that we are facing a correction as opposed to a bear market. Therefore, I am prepared to rely on the ability of our fund managers to deal with this downturn and be in position to profit by what should be the ensuing rally to follow this correction. Yet if the evidence suggests significant market deterioration, we will be forced to take more defensive actions. This analysis pertains to the early to mid part of 2008.

Later in the year, the time leading up to the election should be beneficial for stocks, if history is any guide, because presidential election years are almost always good for stocks. Both parties want to give away the "store" to get elected. It could be more difficult late in 2008 and into 2009 if high tax and trade protectionist elements prevail in the election. As always, we will continue to reassess the situation and keep you posted.

Nine Year Historical Comparison Southern Capital Services, Inc Verses NASDAQ, S&P 500, Value Line and Wilshire Indexes* 1999 – 2007



	Code	Name	Cumulative ROR	Annual ROR
	OTC	NASDAQ Composite (UA)	17.02%	1.76%
	SPC	S&P 500 Composite	38.09%	3.65%
	SCSTC	SCS Total Composite	85.25%	7.09%
	VAL	Value Line Index	-1.88%	-.21%
	WLG	Wilshire Large Co. Growth	2.17%	.24%

Disclaimer: These returns used to measure performance are from historical data and do not guarantee future performance. SCS Composite consists of all accounts held at Fiserv as custodian and is time weighted, dollar weighted and geometrically linked, net of fees containing mutual funds invested at no load. The data for the other indices is provided by Advisory World, Inc.

This historical comparison begins with the volatile year 1999 through the bear market years, 2000 – 2002, and up through the most recent year-end 2007. 1999 was chosen as the beginning year because we feel that it was the year that the stock selection of superior management re-emerged as the deciding factor in fund performance. Whereas the years 1995-1998 represented an unusual period of time when almost every sector of the stock market showed strong appreciation.

NASDAQ Composite (OTC): Tracks the stocks on the NASDAQ stock market. Includes more than 5500 companies.

S&P 500 Composite (SPC): Tracks 500 companies in leading industries such as transportation, utilities, financial services, technology, health care, energy, communications, services, capital goods and more. The calculation for this index equals the price of each stock multiplied by the number of shares held by the public. This is known as a weighted index.

SCS Composite (SCSTC): The weighted return of SCS accounts held at Fiserv. It is time-weighted, dollar-weighted, net of fees and geometrically linked.

Value Line Index (VAL): Represents 1,700 companies from the New York and American Stock exchanges and the over-the-counter market. It is an equal-weighted index, which means each of the 1,700 stocks, regardless of price or total market value are weighted equally.

Wilshire Large Company Growth (WLG): This style invests in the top 750 companies of the Wilshire 2500 with a market capitalization down to approximately \$960 million. The companies selected meet certain target criteria for sales growth, return on equity, and dividend payout.

* These indices were selected because they represent broad measures of the stock market.