

# Southern Capital Perspective

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## SOUTHERN CAPITAL SERVICES CELEBRATES 25 YEARS IN THE FINANCIAL SERVICES INDUSTRY

By Terry Nager

Twenty-five years is a long time to remain in one place and to be involved in the same business. Boredom or a sense of ‘burn-out’ can occur if one lacks change and revitalization. However when dealing with the world capital markets, as we do, change is constant and revitalization takes place continually. Every night before going to bed, I check what is going on in the Asian markets or, if it is really late, the European markets, as well as the news that will affect the US markets when they open. Everyday is different and the unexpected is always happening. This makes the work fun, exciting, and sometimes very frustrating, but never boring.

I consider myself to be very blessed to be able to have as my profession an activity that I greatly enjoy. Working is not a chore if you really enjoy what you do. The markets themselves and the way they operate are fascinating and the constant quest to figure out the appropriate steps to take is an exciting challenge. Yet, one of the most pleasant aspects of our work is dealing with what I believe to be the greatest clientele in the industry. We at SCS are very fortunate to have a client base that is intelligent, understanding and appreciative. Many of our clients have been with us for a number of years – long enough to have been there for the good times as well as enduring the difficult ‘bear’ market years. Some have been with us over 20 years.

Many of our long-term as well as some newer clients were able to join together with us in celebrating our 25<sup>th</sup> anniversary party on Saturday, May 5 at VINO E GRAPPA which is owned and operated by Terry Brown, one of our long-term clients. The party was a great success: there was a good turnout and the food and drink were excellent. Everyone seemed to have a good time and we had the opportunity to honor our most longstanding clients – Dr. David and Marilyn Mullins, who have been with us for the full 25 years (see picture below). All of us at SCS would like to thank David and Marilyn as well as all of our wonderful clients for the confidence that each of you has placed in us by entrusting us with the management of your money.

On the day of the party, I had just returned from a trip to New York where I had the opportunity to meet with Jean-Marie Eveillard – the manager of the First Eagle Global Fund. The occasion was a First Eagle due diligence conference and, as readers of this newsletter are aware, the reason for my attendance at the conference was the abrupt resignation of Charles de Vault as manager of the fund. Since this fund is our largest single position, it was imperative to find out the plan for management succession in both the immediate and the longer-term. With Jean-Marie back at the helm my qualms about the near-term were totally removed.

Jean-Marie Eveillard is truly one of the legendary fund managers who are still active in the industry today. He describes himself as a deep value type investor as opposed to a growth type investor. He is much more concerned with a strong balance sheet, good book value, consistent earnings and strong cash flow for the stocks he buys for his funds than with momentum investing, which is buying stocks when their prices are rising and expected to continue upward, or with the rate of earnings growth. He says that philosophically he falls somewhere between Graham and Dodd (they wrote the book on value investing) and Warren Buffet (one of the greatest investors of all time). Jean-Marie has won various awards through the years for his performance as well as Manager of the Year in his category.



Terry with David and Marilyn Mullins  
Photo courtesy of Paul Burkholder, Jr.



Terry with Jean-Marie Eveillard  
Photo courtesy of First Eagle Funds

During the two-day conference I had two opportunities to speak one-on-one with Jean-Marie. To me this was a privilege and I was able to gain a clearer insight as to the man and a greater understanding as to how he approaches his job as portfolio manager. First, in spite of all his accomplishments he is a very humble and soft-spoken man with a noticeable French accent. He sees himself as a caretaker of the investor’s money with a heavy emphasis on not taking significant losses while being able to take advantage of the opportunities of the positive action in all types of markets all over the world.

FISERV TRUST SOLD TO TD AMERITRADE  
By Eric Nager

On the second day I posed a question to him that I felt was important. I asked him about the sharp correction that the markets all over the world experienced at the end of February of this year. In that downturn all markets went down together - foreign stock, domestic stock, gold, oil, commodities; in other words there was nowhere to hide. My question was unlike the bear-market of 2000-2002 when he was able to average +10% per year, what would happen if there were a deeper correction more like the February 2007 correction? His answer was direct and very interesting. He said if the markets across the board were down, say 20%, he would expect First Eagle Global to be down in the neighborhood of 6%. He readily acknowledged that in those types of markets the First Eagle Global Fund would experience some losses, but they would be a lot less than the market in general. And the fund would be poised to quickly recover from a relatively small loss. In the past I heard him speak at various conferences, but after the opportunity to talk with him individually, I felt more confident than ever and am even more comfortable with him handling a significant portion of our client's assets.

Also, I was able to meet with Charles Lardemelle, the heir-apparent and the one who Jean-Marie is training to ultimately take his place when he goes back into retirement. Lardemelle is the senior analyst for First Eagle and worked with Jean-Marie before he retired in 2004. Jean-Marie has agreed to be the fund manager for one full year and then the second year he will oversee Lardemelle; for the following three years Jean-Marie will be in the role of consultant and Lardemelle will have primary responsibility. I am very comfortable for two years, and after that we will monitor the situation closely.

REVIEW AND OUTLOOK  
by Terry Nager

The first half of 2007 has been similar to 2006 both in respect to total return and in terms of increasing volatility. The number of days with 100 point moves up or down in the Dow Jones Industrials has greatly increased. Although the percentage change shrinks as the average gets higher, there is clear evidence of increased volatility as the bulls and bears fight it out on a daily basis. Even with the daily fluctuations increasing, the trend has been moving positively, roughly at the same pace as 2006 (about at a 16% annualized rate). Quite frankly, the pace of this year's advance has surprised us. We had expected more modest gains at this point in the year considering some of the headwinds facing the economy and the market.

Specifically, there are four headwinds that the market has successfully been able to deal with in the first half of 2007. I will cover these in more depth in the quarterly e-newsletter, but they are the bursting of the sub-prime loan/real estate bubble; rising interest rates; the persistent rise in the price of oil; and the potential for increased capital gains taxes with the change in control of Congress in January.

We believe that the balance of 2007 will see increasing volatility with a likely correction, possibly up to 10%, but more likely of the 5-7% variety. However, we still think that by year-end we will see additional gains from here due primarily to the global economic and stock market booms that are going on.

As you saw in your June monthly statement from Fiserv Trust, the Custodian of assets managed by Southern Capital, they have been sold to TD Ameritrade pending regulatory approval. The deal is expected to close within the next six months. What does this mean to Southern Capital clients? From a service perspective, we are expecting the transition to be relatively seamless. Representatives from Fiserv will stay on beyond the deal's closing to ensure that all goes smoothly. From a cost perspective, TD Ameritrade has promised to maintain Fiserv's price structure for a full year. This means that with the time it will take to close, the current price structure will be in place for about the next 18 months. This will give us plenty of time to look for alternative arrangements, should we feel that becomes necessary.

When we heard the news of the sale, our main concerns regarded preserving the tremendous economies of scale we enjoy trading through Fiserv. For example, we can trade accounts on an omnibus basis. Fiserv charges \$25 to buy or sell a mutual fund, but we can bunch the transactions such that if we had 50 clients moving into or exiting a fund, this is considered one transaction and it would only cost each account \$.50. This is what keeps our quarterly transaction costs so low, usually in the neighborhood of \$10-15, in addition to a modest, flat quarterly custodial fee that is regardless of account size. We are assured this will continue with TD Ameritrade, and in addition, we will be able to preserve the tremendous fund selection we currently enjoy, not having to worry about high fund minimum investments or load charges, which generally do not apply to us as investment advisors. We will continue to be diligent in keeping custodial costs as low as possible for two reasons. First, we receive no part of these fees and we don't want the hurdles to our performance raised any higher than necessary. Second, on a 1% fee basis, we feel that one penny of every dollar under management is ours, and we don't want to spend that penny any more than our clients want to spend their \$.99.

WELCOME, MARK NAGER  
By Eric Nager

Last summer we welcomed Terry's son, Mark, as a summer intern. This spring he graduated from college with a degree in economics and joined the firm on a full-time basis in June as an associate. He will be learning all aspects of the work, from operations to marketing, as he studies for the Series 65 exam. Outside of work, Mark's interests include golf, fishing, and most recently acting, as he has landed a part in the local community theater production of Hamlet. When you call in you will probably hear his voice, so please join us in congratulating him on earning his degree and officially welcoming him to the firm.

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