

# Southern Capital Perspective

October 2006 The Summit, Ste 201A, 29000 Hwy 98, Daphne, AL 36526 Volume 14, Number 4

## HOW IS MY ACCOUNT DOING?

By Terry Nager

In late August I received a fax from a client questioning how his portfolio's performance, considering turnover and management fees, compared to the returns on the S&P 500 Index. He also enclosed an article by Ellen Simon of the Associated Press entitled, "Impossible Dream: Beating the S&P 500". This client was unnerved by reading this article and requested that we do a comparison for the period of time that he has had an account with Southern Capital Services.

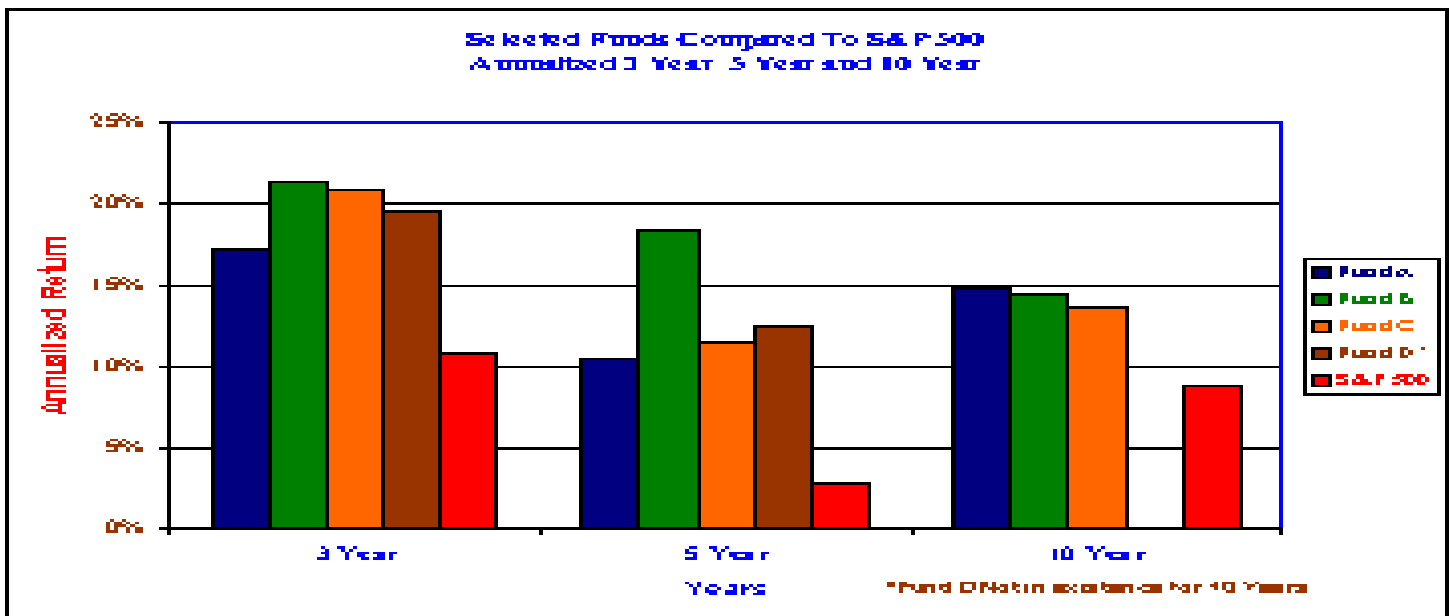
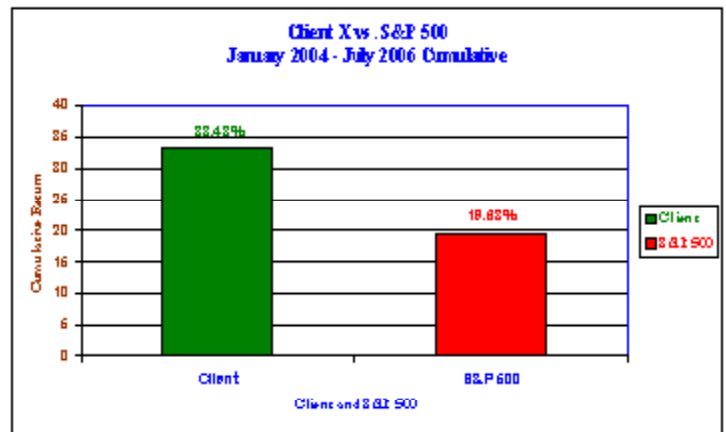
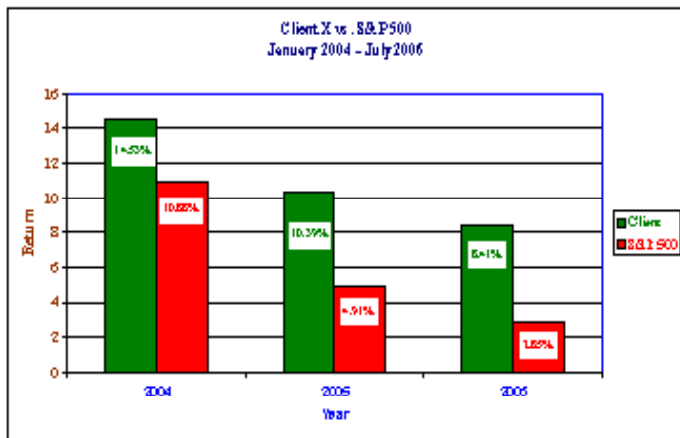
When I read the article, it was clear to me why he was wondering if his portfolio was properly positioned. Here are some excerpts: "If you think you can beat the market, you're probably wrong. And if you think your fund manager can, you're likely wrong again."

"Roughly two-thirds of professionally managed large-cap equity mutual funds are outperformed by the Standard & Poor's 500 stock index after expenses. The one-third that beat the market in any particular year are just as likely to underperform the market in the next year, according to a study by Burton G. Malkiel, Chemical Bank Chairman's Professor of Economics at Princeton University and author of the book 'A Random Walk Down Wall Street'."

"So finding a fund that beats the indexes consistently really is like finding a needle in a haystack. Which brings us back to Malkiel, who writes that the typical equity fund underperforms the index fund by more than 2 percent."

After calculating the client's portfolio rate of return on a time weighted basis we proved that we had found several "needles" for him in the proverbial haystack of the mutual fund ranks. He put his portfolio under our management on 12/16/03. His net return on 7/31/06 after fees and mutual fund expenses was 35.78%\*. (Please note that past performance is no guarantee of future returns.) By contrast, the S&P 500's total return for the period 12/31/2003 – 07/31/2006 was 19.63%. The graph that follows shows a year by year comparison as well as the comparison for the total time period.

The third graph shows the 3, 5 and 10 year returns of the four largest mutual fund positions. These positions together represent over 86% of the holdings in this client's portfolio. This comparison to the S&P 500 covers a longer



period of time than the less than 3 years that the client has been with SCS. Five and ten year long “needles” are even more significant than those that are of only three year duration. We have always believed that those like John Bogle, the former head of the Vanguard family of mutual funds, were correct in stating that the indices outperform about 85% of mutual funds. However, we have a firm conviction that the remaining 15% of funds leaves a sufficiently large universe from which to select, and we feel the evidence has borne out our beliefs.

Although this data indicates that the portfolio results outpaced the S&P 500 for the time periods indicated, it is important to realize that there will be periods of time when the S&P 500 may outperform for months or even years. The SCS goal is always to provide strong relative performance on a risk-adjusted basis over long periods of time.

\*The client actually began as an SCS client on 12/16/2003, but in order to compare accurately, a 12/31/2003 beginning date enables an exact time period comparison with the S&P 500 because of the Advisory World data base that we use. Consequently the return for the period from year-end was 33.43% instead of 35.78%. For additional information regarding the four mutual funds depicted in graph 3 contact Eric Nager by telephone at 251-626-1140 or by e-mail [eric@socapsrv.com](mailto:eric@socapsrv.com).

#### MARKET UPDATE AND OUTLOOK

By Terry Nager

The third quarter started out on the downside as an extension of the sharp correction that began in mid May. However, as July gave way to August and then August to the traditionally weak September, it started to become evident that this year September was going to be a friend instead of a foe. The modestly positive returns for the third quarter – specifically the last month of the quarter – reinforce the wisdom of not accepting the “conventional wisdom” about what is to be expected or is traditional. The reason for pointing out this anomaly is that October is often a transition month from third quarter weakness to fourth quarter strength. And since we are almost half way through the month it is tempting to feel complacent about the rest of the year. However, caution is warranted because although the economic fundamentals are generally positive, there is still the possibility that a fourth quarter correction could be in the works. This could be due to election uncertainty, specifically regarding tax policy, or the ever-present geo-political event. This is not our prediction but it is a nagging concern that keeps us from being 100% unabashedly bullish.

As indicated in the previous paragraph, the fundamentals are bullish and would support a good fourth quarter market rally. For example, the Federal Reserve is on the sidelines, meaning no interest rate moves for the rest of 2006 are likely. Oil prices are continuing to drop due to a mild hurricane season and no major disruptions in the oil flow from the various troubled areas of the world despite many rumblings. And corporate earnings have continued to be relatively strong in spite of the FED’s interest rate hikes intended to slow the economy down. The widely publicized housing slowdown is still a large question mark – will the other sectors of the economy be able to make up for the dip in housing?

Continued Column 2

up in the spring, a usual strong season for housing? Will low energy costs, strong employment, with wages beginning to rise, and stable interest rates at relatively low levels enable the house-buying consumer to stay in the market? Will there be a soft-landing from the housing bubble rather than a hard-landing that many have predicted? Obviously, at this point in time there is no way to absolutely know the answers to these questions, but it seems that the stock market is telling us that for the next few months the outlook is favorable by virtue of the fact that the Dow Jones Industrial Average has soared to new all-time highs. Our outlook is for a positive fourth quarter, although a mid-quarter correction

#### TWO NEW WAYS FOR ELECTRONIC ACCESS TO YOUR ACCOUNT

By Eric Nager

Technology is always changing, so we’d like to introduce two new ways you can access your account information online through our custodian Fiserv. The first is online access to view your account. You have read in the past our instructions on how to view your account through the Accountlynx web site, but this is in the process of being phased out. To register on the new site, go to [www.datalynx.com](http://www.datalynx.com). You will be forwarded from there to the Fiserv home page. This will be your future login page. At the top click “New User” and then select “Client” on the next page. You will be asked to fill out personal information, such as the account number you wish to see. Please remember to put the numbers 019 in front of the account number, since that identifies you with Southern Capital Services. Once you select a login and password, there is a user agreement, and then you can view your account(s) online at any time. If you have any questions you may call Fiserv tech support at 1-800-564-2436.

Another option is to sign up for i-Statements. These are paperless monthly statements you can view online instead of receiving them in the mail. For this site, go to [https://statements.datalynx.com/datalynx\\_home/index.jsp](https://statements.datalynx.com/datalynx_home/index.jsp). On your first visit, click on the Enrollment box where you can then give your account number and establish a login. This can be the same as the one you have for viewing your accounts online. You will have access to all the accounts keyed to your Social Security number. After enrolling, you can click on the Login box for every subsequent time you visit. Once you enroll, your paper reports will cease, but you will have to go to the web site to view your statements. We hope this makes it easier for you to track your investments, and

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