

# Southern Capital Perspective

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## PORTFOLIO SEA CHANGE

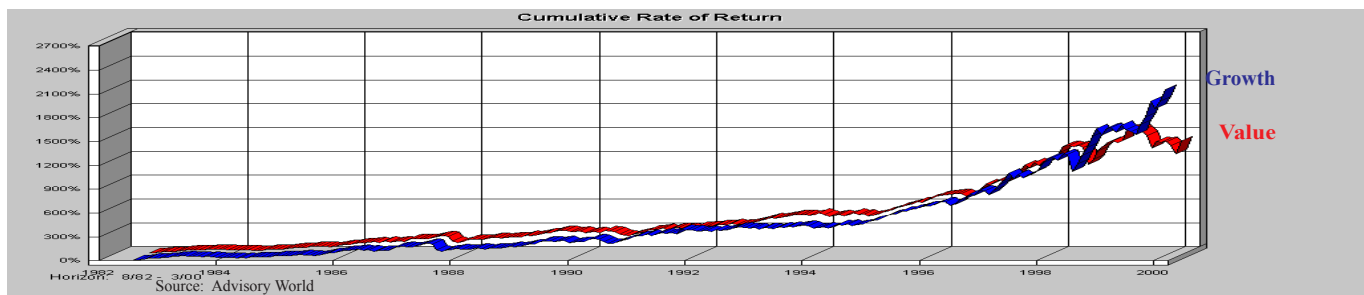
By Terry Nager

Our longstanding clients have observed over the years that seldom does Southern Capital's management style produce a great deal of trading activity in short periods of time. Normally we make incremental changes over lengthy periods of time – we call it phasing-in or phasing-out of a fund position. The last two times that we had a flurry of trading activity were the bear market of 2000 to 2002 and then the transition back to a bull market in 2003. Now, however we again feel that it is necessary to transform the composition of our client portfolios in order to take advantage of the prevailing market conditions. Many of our clients have probably already noticed the increased activity in their accounts.

The change that is being effected is a transition away from a heavy value orientation. This was adopted during the bear-market years and has benefited our clients greatly during the ensuing years. A value orientation seeks to invest in companies that have moderate price-to-earnings ratios and growth forecasts. We are shifting to a more balanced position between growth and value, and possibly even ultimately an outright overweighting of growth. Growth funds seek stocks with higher P-E ratios and growth forecasts. They can be more volatile than value funds, but allow for greater upside potential. This decision was made because during periods of time when P-E's are expanding, it is generally more favorable to growth and when PE's are contracting, it favors value-style investing. The three graphs that follow depict three separate periods of time and show how growth (represented by the Russell 1000 Growth Index) and value (represented by the Russell 1000 Value Index) have performed.

The first graph shows the great bull market from August of 1982 through to the peak in March of 2000. During this time P-E ratios expanded from a low of around 5 to a high of close to 40 (www.CrestmontResearch.com). Growth outperformed value 2152% to 1411% while P-E's were going up.

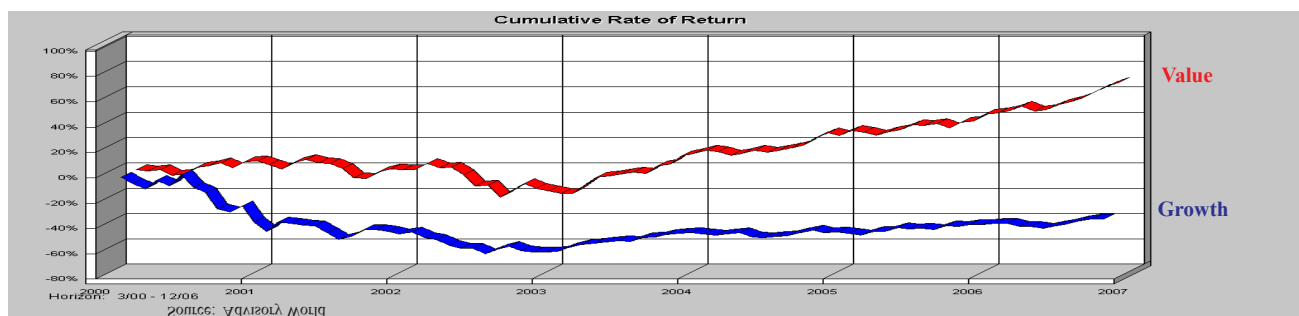
**Comparison of The Russell 1000 Value to Russell 1000 Growth August 1982 – March 2000**



Code	Name	Cumulative ROR	Annualized ROR
R1KGR	Russell 1000 Growth Index	2,151.85	19.38
R1KVL	Russell 1000 Value Index	1,411.25	16.70

The second graph shows the bear market from March of 2000 through the recovery years ending with 2006. During this period P-E's contracted from the near 40 high to the low-to-mid 20's and value outperformed growth +69% for value to -33% for growth.

**Comparison of The Russell 1000 Value to Russell 1000 Growth March 2000 - December 2006**



Code	Name	Cumulative ROR	Annualized ROR
R1KGR	Russell 1000 Growth Index	-33.02	-5.76
R1KVL	Russell 1000 Value Index	68.96	8.08

The third graph shows the year 2007 through September. During this period growth has outperformed value by 6.5%. We feel that with an accommodative FED, lowering interest rates and keeping the money supply elevated, along with a vibrant global economy that P-E's will expand and that growth will continue to outpace value. P-E's have expanded slightly this year and we think this trend will continue.

### Comparison of The Russell 1000 Value to Russell 1000 Growth December 2006 - September 2007



**Disclaimer:** These tables are for historical illustration purposes only and should not be relied on as a predictor of future performance. Actual results will most likely be different.

Code	Name	Cumulative ROR	Annualized ROR
R1KGR	Russell 1000 Growth Index	12.49	16.99
R1KVL	Russell 1000 Value Index	5.97	8.03

**Definitions:** The Russell 1000 Index measures the performance of the 1000 largest companies in the Russell 3000 Index, which represents approximately 92 percent of the total market capitalization of the Russell 3000 Index.

The **Russell 1000 Growth Index** is a subset of the Russell 1000 Index. The Index is capitalization weighted, and consists of those companies, or portion of a company, with higher price-to-book ratios and higher forecasted growth within the Russell 1000 Index. The Growth Index represents approximately 49% of the total market capitalization of the Russell 1000 Index.

The **Russell 1000 Value Index** is a subset of the Russell 1000 Index. The Index is a capitalization-weighted index and consists of those companies or portion of a company, with lower price-to-book ratios and lower forecasted growth within the Russell 1000 Index. The Index represents approximately 51% of the total market capitalization of the Russell 1000 Index.

We always try to think in terms of “what if we are wrong.” Therefore, we have been moving incrementally, albeit over a short period of time, so that if necessary we could halt or reverse the process. Also, even the growth oriented funds that we are using have fared better in the down markets than most of the others in their category, although not as well as value funds. Thus far it seems that we are on the correct path but we are watching very closely to see if there is something or some event that will cause us to shift back in the value direction.

### Market Outlook

The subprime mortgage loan mess, the sagging real estate market, high energy costs, the US dollar sinking in value and doubts about the health of the US consumer are all still with us, yet the stock market keeps climbing. Also, the political landscape seems to be shifting with more talk about trade protectionism and higher taxes. These are normally bearish trends, so what is the stock market thinking about as it continues to rise?

At this time the market seems to be focused on the FED with its accommodative policies, the strong global economy, along with the fact that the lower US dollar is benefiting US exports and the upcoming earning reports which are expected to be pretty good when compared to lowered forecasts. The action of the market indicates that the subprime situation and the real estate market weakness have already been discounted, the high energy costs are manageable, and that it is too soon to worry about the political dangers that may derail the bull move in stocks. We see the fact that the market has been breaking out to new highs as an affirmation that the bull is still intact and probably has further to run. However, we must remain alert and nimble because situations can change rapidly and we need to be able to act accordingly.

### Southern Capital Relaunches Web Site

By Eric Nager

Our very first web site went live almost exactly seven years ago and it served us well. However the web address was a little unwieldy, and advances in technology made some aspects of the site obsolete. We were thus very pleased to engage the services of Marcus Neto of Blue Fish Design Studio to revamp the site, and obtain our new URL: [www.southerncapitalservices.com](http://www.southerncapitalservices.com). Even though this domain name is longer than that for the original site, it will be much easier to remember!

Following this convention, our corresponding e-mail addresses will be David, Eric, Terry, or [Mark@southerncapitalservices.com](mailto:Mark@southerncapitalservices.com). Some of the new features include a history of the company, our new logo designed by Chris Nager, articles we have published outside the newsletter, a list of client services, a blog, and downloadable new account forms. Please note that the forms are password protected, and we can send out the password upon request. Some of the features from the old site that were retained and improved are the FAQ (frequently asked questions), our archive of quarterly print newsletters, our performance record, staff photos and biographies, and the link to our custodian, Fiserv Trust.

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