

# BRADYCO

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Volatility is back. As I have pointed out in the past, volatility is quite common on an historical basis and the relative lack of volatility during much of the past 5 years was itself abnormal. While unnerving to some, volatility can be helpful to long-term investors as it gives us a chance to buy great companies at discounted prices. This was true again in the 3<sup>rd</sup> quarter although the biggest price declines tended to be focused in specific industries – such as financials and housing – rather than the broader based decline we typically see. Thus, most of my purchases were in finance-related companies.

In the end, though, while the stock market had some rough weeks in July and August, it never did have an actual correction (commonly defined as a 10% drop in the closing price of a major index such as the S&P 500 from its most recent high) although it came extremely close. Later, the market rebounded and the S&P 500 index ended up about 2% for the quarter (9.1% YTD).

So where do we go from here? Despite the fact that oil prices are up over 50% from last January and the dollar has fallen significantly against most major currencies, the stock market has begun the 4<sup>th</sup> quarter by setting some new all-time highs based on the apparent belief that the worst of the credit crisis is behind us. (For more on this, see article below.)

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*This letter continues the segment discussing factors used to invest your money.*

Is the storm really over? This summer saw some challenging conditions in the U.S. credit markets. In response, the Federal Reserve Bank lowered two different interest rates and took other steps to bolster the financial markets. So far, the Fed's actions have worked. Still, many uncertainties remain including: (a) who actually owns all the sub-prime mortgages and how much pain will the defaults cause? (b) will housing problems spread to other areas of our economy? and (c) will high oil prices and the falling dollar cause inflation?

While future economic trends are always difficult to predict, with all the changes in our economy during the past 10-20 years, including globalization and various financial innovations, I believe that old economic models -- that in the past would have guided our leaders in predicting the answers to some of these questions -- no longer work. Instead, the Federal Reserve must navigate uncharted waters, which increases the risk of a miscalculation.

Still, given the resiliency and adaptability of our economy, our economic system should be able to deal with any of these issues. In the unlikely event that such changes do not proceed in an orderly fashion, our financial system could get strained. If this scenario did occur, I feel confident that our investments are well positioned to survive the resulting storm.

Thank you for your confidence.



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