THE DANA VIEWPOINT

*September 4, 2007*
*Dow: 13,372*

# *TOUGH LOVE*

President Bush stated last week that the US wouldn't bail out speculators in the sub-prime lending crisis. He also acknowledged that there were excesses in the lending market, and that homeowners with good credit histories who are behind on their payments could refinance into federally insured loans. Fed head Bernanke then followed by stating that the Fed "will act as needed" to limit the impact of financial distress on the economy, but it won't rescue lenders or investors. Let's hope they both stick to their convictions. Every time the government steps in to rescue speculators in one financial crisis (savings and loan crisis or CMO crisis to name just two) it leads to a far worse crisis down the road as speculators feel they can take on more risk as they will always be bailed out by the government (read taxpayers). Printing money is not the answer either as that will lead to inflation (more money chasing fewer goods is inflationary) and possibly to the next problem – a currency crisis as each nation prints more and more fiat currency.

There is more than adequate money on the planet; it's just there is currently a lack of confidence to lend this money. Michael Milken once said: "Liquidity is an illusion. It's always there when you don't need it and rarely there when you do."

The bad news is that there may be another shoe or two to drop, and the real bad news is that Congress is back. What we don't need right now is government interference. The free markets will work this out just fine thank you. The Bush/Bernanke strategy of a helping hand not a handout is what the government should be doing.

So, will the Fed cut interest rates like many would like to see? Only if the Fed senses that the housing market is likely to drag down the entire economy. We think that is highly unlikely. Interest rates are already at historic lows. Also, remember that Japan held interest rates near zero for a decade and still couldn't shake their recession. It was only when they increased their money supply and Japanese investors recognized the global expansion occurring did confidence return and start another boom in their economy. Money is not the problem here nor are interest rates. Gross Domestic Product for the second quarter was recently revised up to a 4% annual rate. We don't expect that rate to

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continue, but growth should remain solid at least into next year. Earnings reports will be hitting the papers starting mid-September and should make for good reading. If that doesn't jump start investing in stocks then the Fed could cut interest rates by a quarter of a point to 5% which would boost investor confidence.

What could go wrong? Well, with Congress in session we could see reams of legislation and regulation which would hamper economic recovery. Worse still would be further calls to repeal Bush's tax cuts. The rest of the planet is in a race to lower taxes as they see their neighbors' economies boom after a tax cut. Even former communist countries are cutting taxes and are considering flat income tax rates. Tax cuts make more money available for investing, which creates more jobs.

Most trading in stocks and bonds right now is on the margin. That is, speculators, traders and bargain hunters are driving the daily volatility in prices. Common sense does not apply at the margin. Changes in expectations tend to be magnified at the margin and emotions are stronger than reason. Bernard Baruch once observed: "What registers in the stock market fluctuations are not the events themselves but the human reaction to these events, how millions of individual men and women feel these happenings may affect the future." Moreover, there is a rhythm to the marketplace, and trends tend to reinforce themselves. Right now the news as reported by the press is bad, but at some point prices become impervious to further decline and the trend reverses. We are seeing signs of that happening right now. So, it is best at this time to think about whether conditions are changing for the better relative to expectations and not whether they are currently good or bad.

**Random thought for September:**

The most terrifying words in the English language are:

"I'm from the government and I'm here to help."

*Ronald Reagan*

Michael L. Dana

Michael L. Dana
Chairman of the Board

James Ivey

James W. Ivey
President

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