

THE LANCZ LETTER

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INVESTORS WAKE UP TO RISK

Our last issue entitled *Strategic Profit Taking* (5/30/07) attracted a lot of attention. It wasn't because we were stating anything profound, but rather during a time most investors were euphoric and enjoying new daily highs, we expounded on the virtues of profit taking to reduce risk. The end of May marked a time when risk was virtually ignored and expectations were increasing each and every day. When the Shanghai market plunged in late February, the U.S. market followed suit with a significant 2-3 day sell-off before beginning to stabilize. Last month, when the Shanghai market fell even more than in February, the U.S. market was sharply lower for 2-3 hours before starting to rebound by early afternoon. On June 1st when the U.S. markets hit another all time high in the D.J.I.A. and a seven year high in the S&P 500, we were questioned on why we are recommending taking profits when the U.S. market looks so resilient. We stated that it is times like these (when everyone is looking at the glass half full) that investors have to be particularly careful. If the stock market continued this upward trend throughout the summer, we would have increasingly raised cash expecting a major correction in late summer or fall. Instead, the equities markets started to decline after a sudden spike in interest rates during the first week of June. Concerns over sub-prime loans, exasperated by the bail-out of a Bear Stearns hedge fund, has brought on a new batch of volatility and selling pressure. This has occurred despite a slight reversal of late in the upward trend in interest rates and energy prices. The more equity valuations go down the more we hear talk of a further collapse in stocks on the horizon. The financial sector comprises over 20% of the S&P 500 and any further fall-out in the sub-prime arena will definitely have a dramatic and immediate impact in the financials as well as the overall market. **So there is cause for concern, but the smart investor should realize that as prices decline it is time to get progressively more optimistic, not less.** Such

strategic and disciplined behavior will seem foreign to the average investor who was buying into the euphoria through last month. At that time any consideration of the risk being taken was either substantially underestimated or totally ignored. **This month investors finally woke up to that four letter word that too often is not taken into consideration by even the professionals on Wall Street.**