

# Southern Capital Perspective

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## 2006 WAS A GREAT YEAR FOR THE STOCK MARKET!

By Terry E. Nager

The Southern Capital Services composite of all the money we manage returned slightly over 16%\* (net after fees) in 2006. This makes us very happy since we were anticipating a good year but not an outstanding one. However, our elation was dampened somewhat by the fact that we were only slightly ahead of the S&P 500 Index by less than one percent. Around the office we jokingly say that “we had an absolutely great year but a relatively awful one”. A total return in the mid-teen percent range is great in absolute terms but outpacing the index by less than one percent is not as great relative to the market as a whole.

\*Past performance is no guarantee of future returns!  
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## WHAT IS ON THE HORIZON FOR 2007?

by Terry E. Nager

At first glance, it would appear that a continuation of 2006 would make sense and it would certainly make for a lot of happy investors. However, there are some significant bumps in the road that will have to be resolved in order to bring about a rosy scenario.

First, the deflating housing bubble will have to at least bottom out if not begin to recover. Housing is in the judgment of many to be America’s most important industry because it affects almost all of the other industries. For example: two key commodities –copper and lumber- are greatly affected by housing demand. Home furnishings, construction, real estate sales and the mortgage finance business as well as the ripple effects of all those employed by these industries are just some of the direct impact that a major extended housing slowdown would bring about. This is a big concern, but on the bright side employment and business activity have remained brisk and have not as yet shown the dramatic effects of a housing collapse. Also the homebuilding stocks have shown some signs of bottoming out and beginning to recover which is often the harbinger of better things to come.

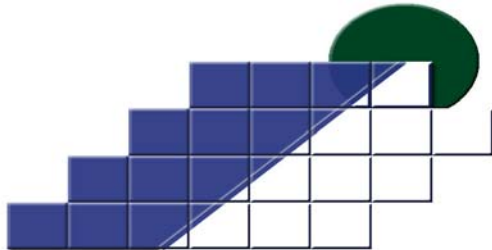
Second, there are potential changes in tax policy as a result of the Democratic takeover of both houses of Congress. Any increase in taxes is almost always negative for stock market investors, however if the new powers that be can refrain from changing the tax laws as they pertain to dividends and capital gains, I believe that the damage will be minimal. It would certainly be negative if the cap on social security taxes is removed, the marginal rates are increased and the estate tax is resurrected, but they would not be as directly harmful to investments as increasing the dividends and capital gain rates.

Third, and this is maybe the most influential, is FED policy and interest rates. FED chief Bernanke will have a major role in how the market plays out this year. He has said that their actions will be data dependent, which means that it depends on how the FED reads the tea leaves. Bill Gross, the head of PIMCO’s bond mutual funds, is the largest bond manager in the US and has repeatedly said that interest rates will fall by as much as a full percent in 2007. He believes that the economy will slow and the FED will drop rates. If he is correct and he often is, unless the slowdown becomes an outright recession, stocks can have a significant rally even with very modest corporate earnings increases. If this scenario plays out, we could have a good market even with a relatively flat economy.

In conclusion, I think that as events unfold neither the rosy optimists nor the gloomy pessimists will have their way. My best guess is that the housing situation will be difficult but not disastrous, the Democrats will restrain themselves because they do not want to damage their prospects for 2008, and Bernanke’s actions will be very modest or less than what most people expect. In my opinion, barring a catastrophic geopolitical event that cannot be foreseen, 2007 will be more volatile and not be as strong as 2006, but should be another positive year.

## Southern Capital Services Unveils New Logo

by Eric Nager



As Southern Capital Services celebrates 25 years of investment excellence this year, we thought it was time to unveil a new logo that embodies the qualities we strive to express and symbolizes the nature of our work. Our thanks go to Chris Nager, Terry’s son, who is studying graphic arts at Samford University for his efforts on the logo. He worked with us during his summer break and observed our operation to come up with ideas for the colors and design.

First, a little background on our past symbols and colors is in order. For our formal presentations, we produce a binder with a dark blue cover and silver lettering. Prior to now, our only logo was the Southern Capital initials joined together to form SCS. Since silver is not a practical color for our stationary and business cards, they have been a conservative, professional gray. Once we developed our web site in 2000, we have added blue to our cards and letters for the web address.

The dark blue in the new logo represents a continuation of the Southern Capital tradition of service and excellence. But instead of silver or gray, the bottom half is white to create a sharper contrast. The stair step design represents the market over time. There are stops and starts, but the overall trend is upward, as represented by the arrow. The introduction of the color green at the top symbolizes the ultimate goal of making money for our clients. This is achieved through wise management under all types of market conditions. We hope you enjoy our new logo and what it represents. It’s possible you will see it in limited advertising use later this year.

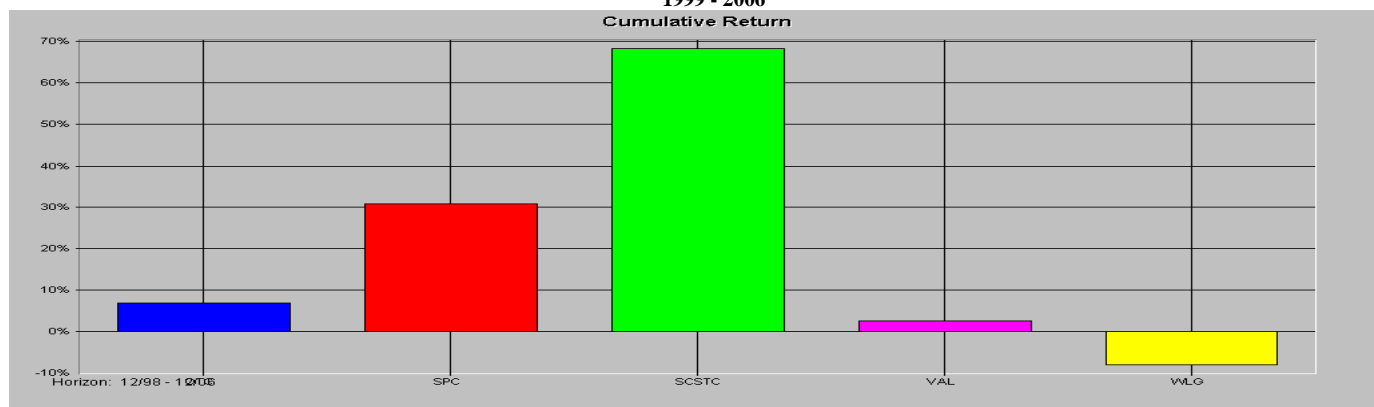
## Eight Year Historical Comparison

Southern Capital Services, Inc

Verses

Nasdaq, S&P 500, Value Line and Wilshire Indexes\*

1999 - 2006



Code	Name	Cumulative ROR	Annual ROR
OTC	NASDAQ Composite (UA)	7.02	.085
SPC	S&P 500 Composite	30.90	3.42
SCSTC	SCS TOTAL COMPOSITE	68.40	6.73
VAL	Value Line Index	2.65	.33
WLG	Wilshire Large Co Growth	-7.94	-1.03

**Disclaimer:** These returns used to measure performance are from historical data and do not guarantee future performance. SCS Composite consists of all accounts held at Fiserv as custodian and is time weighted, dollar weighted and geometrically linked, net of fees containing mutual funds invested at no load. The data for the other indices is provided by Advisory World, Inc.

This historical comparison begins with the volatile year 1999 through the bear market years, 2000 – 2002, and up through the most recent year-end 2006. 1999 was chosen as the beginning year because we feel that it was the year that the stock selection of superior management re-emerged as the deciding factor in fund performance. Whereas the years 1995-1998 represented an unusual period of time when almost every sector of the stock market showed strong appreciation.

### Index Definitions

**NASDAQ Composite (OTC):** Tracks the stocks on the NASDAQ stock market. Includes more than 5500 companies.

**S&P 500 Composite (SPC):** Tracks 500 companies in leading industries such as transportation, utilities, financial services, technology, health care, energy, communications, services, capital goods and more. The calculation for this index equals the price of each stock multiplied by the number of shares held by the public. This is known as a weighted index.

**SCS Composite (SCSTC):** The weighted return of SCS accounts held at Fiserv. It is time-weighted, dollar-weighted, net of fees and geometrically linked.

**Value Line Index (VAL):** Represents 1,700 companies from the New York and American Stock exchanges and the over-the-counter market. It is an equal-weighted index, which means each of the 1,700 stocks, regardless of price or total market value are weighted equally.

**Wilshire Large Company Growth (WLG):** This style invests in the top 750 companies of the Wilshire 2500 with a market capitalization down to approximately \$960 million. The companies selected meet certain target criteria for sales growth, return on equity, and dividend payout.

\* These indices were selected because they represent broad measures of the stock market.

We strive to always have double digit positive returns and at the same time always beat the S&P 500 by a few percent, but the reality is that it doesn't work out that way every year. According to John Bogle, the former head of the Vanguard Group of mutual funds, the index will outperform about 85% of money managers, so any time we beat the index it's a good year. We usually have relatively stronger performance during years that are sideways or even in down or "bear" markets. The very strong up or "bull" market years sometimes results in our portfolios being outpaced by the index, as in 2003. Why this pattern occurs can be seen in the nature of the mutual funds that we use and by the portfolios we assemble on behalf of our clients. Our portfolios generally are well diversified and are composed of funds that individually as well as collectively have shown historically less exposure to volatility, the way we define risk. The diversification and the value-oriented approach has usually provided our clients with good relative year-in and year-out performance except in the strongest "bull" market years. In those types of years a concentrated non-diversified approach will generally post higher returns. However, our commitment to compounding through reduced volatility tends to keep us on our present tack, even if we are occasionally bested by the index. The graph and table on the backside of this newsletter are the evidence as to why we are steadfast in our belief in this approach.