

HAYES ASSET MANAGEMENT LLC



<u>Index Returns 2011</u>		<u>Treasury Yields for 07/31/11</u>		<u>Commodities for YTD 07/31/11</u>	
DOW JONES INDUSTRIALS	4.88%	6 Month T-Bill	.165%	Oil	1.81%
NASDAQ	3.90%	2 Year Note	.356%	Natural Gas	10.74%
STANDARD & POOR 500	2.75%	10 Year Bond	2.795%	Corn	18.86%
DJ TOTAL STOCK MARKET INDEX	2.66%	30 Year Bond	4.125%	Wheat	16.33%
BARCLAYS CAPITAL AGGR. BOND	4.37%			Gold	13.90%

“Home life ceases to be free and beautiful as soon as it is founded on borrowing and debt.”

-Henrik Ibsen, Norwegian playwright of the late 19th century

That quote is as relevant today as it was over 100 years ago.

The historic S&P downgrade of the U.S.’ sovereign debt, of one notch from AAA to AA+ on Friday August 5, 2011 should have never happened. The U.S. would not have been in that position had we not accumulated so much debt. Other market crashes or severe downdrafts have been precipitated by debt binges. Lehman’s demise in 2008 came when it was leveraged 30 to 1! 1997 saw a similar market action because of Long Term Capital’s blow-up due to the hedge fund’s debt levels. Individuals borrowing more than they could possibly repay, in order to speculate in the stock market, brought on the Great Depression. The common thread running through all these market crashes always comes back to too much leverage or debt. What has the U.S. done to address this problem? It has raised the debt ceiling! We are now waiting for a 12-person commission to come up with a plan by November 23rd. We thought that had

been taken care of by the Bowles Simpson Debt Commission.

There is one other common thread that has also accompanied the above market breaks. The equity markets have always come back. We may not know when, but we do know they rally.

“Stocks are safer than bonds,” said a guest on CNBC on July 18th 2011. It’s quotes like that which make the hair on the back of my neck stand straight up. That quote was made in the context of bonds offering such skimpy yields that it made/makes more sense to buy dividend paying stocks. However, since July 18th, domestic stock indexes are down from 12 to 15 percent. At the same time Barclay’s Aggregate Bond index is up 1.83 percent. Stocks are not safer than bonds.

We have been in the midst of a vicious market sell-off.

August 8, 2011 saw the Dow fall 643 points and all 30 stocks in the Dow Jones Industrial Average and all 500 stocks in the S & P 500 declined. In the first week of August the Dow declined 10.98%, the S&P 500 was down 13.37%, NASDAQ was down 13.46% and the DJ Wilshire 5000 was down 14.41%. It was unprecedented to lose that much money in six trading days. As the stock market has declined, U.S. Treasuries, yes those downgraded securities, have been the beneficiaries. Even at AA+ they are still perceived as a safe haven and a liquid market in times of uncertainty. There is never an outcry about volatility when the market goes up. But when it goes down, volatility is the culprit. Today that volatility is partly caused by high-frequency trading (HFT). HFT is the use of sophisticated technological tools to trade stocks and options. HFT starts and ends the day with no investments. HFT does not benefit the markets or society. The supposed liquidity it adds to the market is worthless. Regulators could and should put a stop to this rogue trading. All the regulators have to do is re-instate the up-tick rule, a trading restriction that disallows the selling of securities except on an up-tick. The up-tick rule went into effect in 1938 and was removed in 2007.

RECENT PURCHASES AND SALES

Equities:

Since we last wrote, we've made two new equity investments, Cheung Kong Holdings, LTD (CHEUY) and St. Joe Company (JOE).

Cheung Kong is the flagship of Cheung Kong Group, the leading Hong Kong based multi-national conglomerate. It has interests in the following: Real Estate Property, one of the largest developers in Hong Kong, a 45.31% stake in Hutchison Whampoa Ltd. (another of our Hayes Asset Mgt. core holdings), a 45.31% investment in CK Life Sciences Int., a bio-tech company. Cheung Kong also has a portfolio of other leading

publicly traded companies based in Hong Kong. Finally, its chairman, Li Ka Shing, Asia's Warren Buffet, is obviously a great asset.

St. Joe Company is one of Florida's largest real estate development companies and Northwest Florida's largest private landowners with holdings of 574,000 acres. Two-thirds of the land is within 15 miles of the Gulf of Mexico. Last time we checked they were not making any more real estate in Florida.

Fixed Income:

On August 18, 2011 ten year Treasuries briefly traded at 1.94%, below 2%. Once again interest rates are at generational if not at all time lows. We continue to purchase Floating-Rate securities tied to short-term interest rates (LIBOR) and inflation (CPI) in anticipation of rising rates/inflation. Similar to a pendulum, the Federal Reserve's policy of 0% interest rates will give way to a rapidly rising interest rate environment. Municipal bonds are still attractive versus treasury and corporate bonds.

Historical benchmarks say stocks are cheap compared to bonds. At Hayes Asset Mgmt. we are putting together a shopping list of businesses we would like to own, establishing prices we are willing to pay and waiting for the right time to buy. Warren Buffet has a classic quote from Berkshire Hathaway's 1998 annual meeting that we take to heart. "The stock market is a no-called strike game. You don't have to swing at everything. You can wait for your pitch." The problem when you are a money manager is that your fans keep yelling, 'Swing, you bum!' Again, as we have said for years, patience is a virtue. Avoiding emotionally charged decisions during market turmoil tends to produce positive results. The indiscriminate selling caused by HFT creates opportunities for value investors like us.

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Specializing in:

- Equity Accounts
- Fixed Income Accounts
- Balanced Accounts

- Mutual Fund Accounts

Serving:

- Individuals
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