CASTLEMOORE INVESTMENT NEWS

Uniquely Superior Portfolio Management

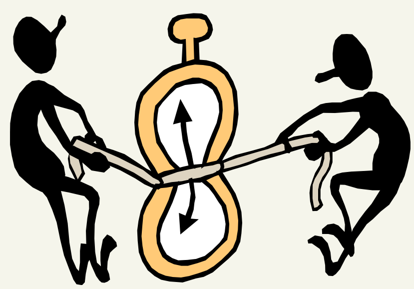
Sub-Prime: The Understatement of the Year 2007

By Ken Norquay, CMT & Partner

What's all the fuss about? Summer 2007: Why did the central banks of the most sophisticated economies in the world have to bail out the Big Banks? Autumn 2007: Why did the CEOs of America's biggest bank and biggest brokerage firm resign? Why did Citibank and Morgan Stanley have to get financing from The Saudis and from China? Why did several Canadian banks announce monster "write-offs?" Why did the European central banks loan $500 billion to European big banks? What's wrong?

It appears that million of Americans cannot afford their mortgage payments. As they hand their keys back to the lenders, houses have to be sold to pay off the defaulted mortgages. The selling pressure of all those extra houses on the market has caused a down trend in US house prices. If a home owner was having trouble making mortgage payments, and their mortgage was $300,000 –but the value of their house has dropped to $290,000, it makes them more likely to give up and walk away. In addition to that, potential home buyers are reluctant to buy when prices are going down. Increased supply of houses for sale, decreased demand: the down turn feeds on itself. It's like a spiral – lower house prices cause even lower prices.

The reason that the world's central banks have been so aggressively lending to the Big Banks stems from the way the banking system is structured. A bank has a certain amount of capital or the net worth. It also has a certain amount of deposits, the amount of money their customers have placed in accounts and investment certificates. The amount of money that a bank can lend to do its business is a multiple of their capital and their deposits. If their capital includes $1 billion of American sub-prime mortgages, and they realize that millions of Americans can no longer afford their mortgage payments, they realize that their $1 billion might not actually be worth



anywhere near $1 billion. And if their capital shrinks by a billion dollars, the amount of money they can lend to their customers shrinks by a multiple of a billion dollars. That means they have to call a multiple of a billion dollars of outstanding loans in. How does this affect the homeowners and businesses to whom they have loaned the money? Suddenly those borrowers have to find the cash to pay off these loans. Where will they find that cash? Will they have to sell assets to pay off the loans? Do you see how deadly this downward spiral can become?

It happened in 1987: the stock market crash created a jolt in the financial world, something like the sub-prime mortgage jolt we are in now. During the subsequent two or three years the squeeze spread to the Savings and Loan business (several US trust companies had to be bailed out) and then to the junk bond market. Junk bonds was an unkind slogan that described corporate bonds that were rated below investment grade. (I wonder if we'll hear the slogan "junk mortgages" in 2008?) In those days, the US Federal reserve board recognized the problem and everyone in the financial community muddled through the crises. And, when it was all over, the economic boom of the 1990s emerged.

A similar squeeze occurred when the high tech boom of the 1990s collapsed in 2001 and 2002. The economy muddled through somehow, and gave rise to the resource boom of 2003 to 2007.

Right now, we are in the "squeeze" stage. Everyone recognizes the sub-prime problem and everyone is cooperating to solve it. And we hope they are successful. If the spiral gets out of control, we could enter the "crunch" stage. In a credit crunch, cash is king. Right now CastleMoore clients hold very high levels of cash.

If a credit crunch occurs, we hope to buy into the stock market near the bottom. We are prepared.

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The Canaries in the Coal Mine

By
Robert "Hap" Sneddon
FCSI, President

The last year has been a wild ride for investors to say the least. Bonds, T-bills, equities, currencies and mortgages -the gamut- have had large swings in a very short time span, especially in Canadian dollars. Any investor ideally wants to only own investments that are going up. The trick in these times is to figure that out. Just what is going up? What's going down?

While being primarily model focussed, that is to say, using a system based on preset indicators or variables, we always look around at supplemental evidence in making decisions, for purchases or sales.

Here's a few things that we are watching that give us pause and that may eventually blow off the markets, but that also tell to us opportunity is close at hand.

PREFERRED SHARES

Today, preferred shares, particularly ones issued by banks and insurance companies, are either presenting exceptional value at these prices or are trying to tell us something else. Preferred shares tend to be the quintessential buy and hold security. The recent volatility in equities has seen support for bonds rise as people seek safe havens. Preferred are down 20% in a year! Why? Simply put shareholders are worried about issuers' ability to keep their dividend commitments. Once this relationship trend stabilizes, we'll

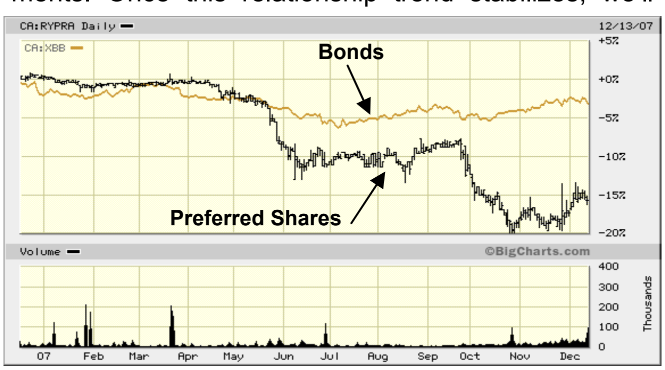

Chart showing the divergence between bonds and preferreds

pull out our Preferred shopping list and buy the best quality.

DOW THEORY

The Dow Theory was formulated by Charles Dow over 100 years ago from several editorials in the *Wall Street Journal*. The theory is a way to gauge business conditions, and hence market direction.

If the economy is healthy then the overall average, the Dow Jones Industrial Average and the transportation sector should move in the same direction. If an economy is healthy goods must be transported.

Coming off the bottoms in August a divergence between the average and transports has appeared. While still too early to create a definitive picture, the 5% spread in returns in 4 months is a fact.

Divergence between the DJIA and Dow Transports

Mutual fund mangers and investors alike, want to keep trumpeting that things are on track. Sherlock Holmes would say something's afoot here.

MAJOR INDICIES UP RELATIVE RANKINGS

At CastleMoore, we lean strongly on research that ranks on both a monthly and weekly basis, the various industries, the index itself, as well as small and mid cap sectors, all in one table. There are 16 things to re-order each week and then again each month , 1 through 16, based on their individual strength. In a broadly rising market the TSX index itself should be found somewhere around the middle of the ranking tables. As we move through the different market cycles the index usually stays put while the stronger sectors move to the top of the tables and the weaker ones to the bottom.

Lately, the index, has moved into the top 5. What does this mean? In short, a narrowing market. Investors see this in the daily headlines with oil and gold taking the lion's share of copy. Most other sec-

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"Buy, Hold...And Know When To Sell"

CastleMoore Inc. helps investors manage their life savings. We are not stock brokers or mutual fund salesmen. We are discretionary investment managers specialising in "buy low, sell high" strategies instead of "buy and hold" strategies like the other guys.

At CastleMoore we manage our clients' investments through a methodical and disciplined set of systems that virtually removes any individual bias and emotion from the investment process. What we do works. We rely heavily on loss avoidance techniques when making investment decisions.

Our clients are investors that pay particular attention to asset prices, have little tolerance for investment losses, and strong expectations of getting their money's worth. Clients appreciate CastleMoore's all-inclusive, comprehensive fee schedule. If we are required because of volatile markets, to be more active within our client accounts CastleMoore bears all the costs associated with more frequent transactions.

Our team's previous experience in national and international firms and small boutiques provides us the ability to deliver a high quality and cost effective professional portfolio management service. A CastleMoore client enjoys the benefits of having focused portfolio management without the distractions of also providing a "super market" of financial services. We just manage investment portfolios effectively – plain and simple. CastleMoore is uniquely superior portfolio management. To know more, including how we gradually and gently transition your existing portfolio to our models please contact us at:

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Canaries in the Coal Mine continued...
tors are showing very poor relative performance. Narrowing leadership forces investors into fewer and fewer sectors, while also raising the risk of the overall market.

COPPER: THE LITTLE METAL TELLS A BIG STORY

It is said that copper is the metal with a PhD in economics. Copper reflects business activities in ways not always apparent by casual observation.

Copper is used in the most diverse businesses from electronics to autos to construction. Its use is widespread. If you want to know what business conditions could be like in 6 months pay attention to copper prices.

Today copper stands at a around $3.20USD/lb. In 2003 it was trading at $0.90. Not bad. India and China's move into the developed world should put a long term bid under prices. Continuous global innovation in tech should do the same .

The chart is noting that on an intermediate basis (6 months up to 2 years) copper is testing support at around $3.00 level. Watching copper prices helps us to allocate between classes and, most importantly to identify opportunities for our clients.

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I Liked the Company So Much....

By
Thomas Kleinschmidt
Client Service

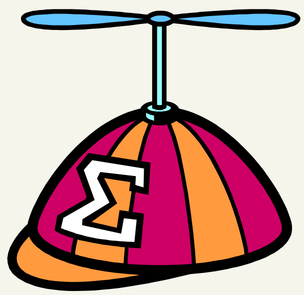
I joined the company! For my inaugural submission to the CM Newsletter I wish to say hello to all readers and to thank Ken, Hap and Sheldon for their support for this opportunity to expand my services into Toronto's financial arena.

You could say that I joined the ranks of the CastleMoore methodology after the popping sound that was the tech bubble. Like most investors, I did not know what my 'Level of Investor Consciousness' was. More to the point, I did not realize just how incongruent we were with our financial planner's buy & hold and "never sell" approach. I felt the pain of watching our assets go down, further and further, losing *years* of savings and *decades* of growth. Sure, it was a costly mistake, and we felt let down by those entrusted with our portfolio, but that day I understood that selling, when the time warrants, is a good thing; indeed the right thing to do.

It was through the Getting Technical newsletter (of which Ken is an analyst and CastleMoore an ally), that I became involved with the company. In searching out a better way to manage investments I saw that CastleMoore invests like I would expect to have my money invested: ***Buy-Hold and Know When to Sell.*** Our hallmark is methodology without the lethal encumbrances of fear or greed.

Knowing when to sell is the key. For me, I learned how to trade on my own but it took years of study and experience. The shorter route is to learn from others. This is what CastleMoore does and why I joined them.

I am a Level 5 Two-Way investor. Most of our clients are Level 4, Focus investors, having switched from the Level 2 'never sell' philosophy. Please note, if you have never been able to judge what kind of investor you are we can help. All you have to do it listen to our CD or website audio tracks on your own.



The Freshman say a few words...

Now you know a bit about my background. Please permit me to discuss my focus: helping finding dissatisfied investors, showing them a better way and inviting them to 'cross the moat' to the safety of CastleMoore (hopefully before the next popping sound.)

The bigger question that a lot of investors have is "What is the market going to do? Are we in a bubble? What effect is the credit crunch going to have on our retirement savings?" Both Ken and Hap discuss the current situation, and what our eyes are fixed on, and the opportunities we see for our clients around the corner.

Currently (JAN08), CastleMoore heeded the early warning signs and our clients are roughly in 70% cash. Sure, there have been some short term moves— but we're not Mario Andretti and this is not the Indianapolis 500.

Our strength is that we identify longer term trends and sell when necessary. Selling can be a radical concept in the large institutional firms! In fact, high cash levels, protect our clients in times like January 2008.

Despite our vast logic potential, we human beings are incapable of making rational decision while riding an emotional roller coaster. We might be right once in a while but it won't be because of logic or rationality! If you feel like this quite often then most likely you are a Level 3/4/5 investor who needs to reconsider your current relationship with your Level 2 money manager.

We're not buy and hold managers. When it's time to protect your assets – to raise the drawbridge – we'll do just that.

CASTLEMOORE INC. is looking for dissatisfied investors who want to become satisfied. Your portfolio is evaluated weekly, watched daily, and reported to you monthly.

For more information or the keys to the drawbridge, call or email:
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