The Prudent Investor

January 7, 2008

Performance Overview

For the month of December the Model Stock Portfolio gained 2.6% versus a loss of 0.7% for the S&P 500 index (including dividends). This represents a gain of 3.3% over the S&P 500 index for the month. Table 1 shows the Model Stock Portfolio monthly and annual returns since January 2003. Year-to-date the model is down –23.0% versus the S&P 500 index's total return of 5.7%.

Table 1: Model Stock Portfolio Returns[1]

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	TPI Total Return	S&P 500 Return
2003	0.5%	1.2%	4.1%	9.5%	9.8%	6.9%	3.5%	(0.9%)	2.7%	19.2%	8.8%	8.8%	102.3%	28.7%
2004	1.4%	9.7%	3.1%	(7.6%)	1.6%	6.3%	1.7%	1.8%	5.3%	(2.2%)	11.5%	5.6%	43.7%	10.9%
2005	4.1%	2.1%	(6.3%)	(2.3%)	7.1%	6.6%	3.6%	(4.7%)	(3.0%)	(3.2%)	5.3%	2.8%	11.3%	4.9%
2006	6.6%	(3.5%)	3.4%	0.1%	(2.8%)	2.2%	(2.8%)	3.3%	1.4%	9.1%	3.0%	2.7%	24.2%	15.8%
2007	3.3%	(1.0%)	0.1%	7.7%	6.9%	(2.1%)	(18.2%)	(11.0%)	0.4%	(0.2%)	(10.9%)	2.6%	(23.0%)	5.7%

Market Valuation Update

Using our modified Fed Model to gauge the fair market value of the stock market, we estimate that the market is currently undervalued relative to bonds by 29.5%. This suggests a relatively strong buy signal for stocks. See our website at www.PruInvestor.com for more information on the Fed Model.

Model Stock Portfolio

The Prudent Investor's Model Stock Portfolio for the current month is presented in Table 2. On January 1, 2005 the model was reset to equal to $50,000.

In Table 2 the column entitled "Target Ownership" represents the ideal percentage investment of each asset in the model portfolio. The Actual Ownership column (far right) represents the model's actual ownership from month to month of each stock. The two are not always identical because we take into consideration trading costs when reallocating the portfolio each month. In general, we do not adjust the allocation until the size of adjustment for any given security exceeds 2% of the total portfolio size. The Target Ownership also differs from the Actual Ownership column because we cannot buy fractional shares of a security to meet the Target Ownership percentages.

Starting a Portfolio: If you are just getting started, we recommend that you purchase all the securities in Table 2, using the Target Ownership column to calculate the number of shares needed for each security. If you do not have at least $50,000 available for investment purposes, you may wish to follow one of the Asset Allocation Models presented below and purchase mutual funds instead of individual stocks.

If you have less than $50,000 to invest but would still like to follow our Model Stock Portfolio, consider the following alternative strategy: Purchase the top 10 ranked stocks shown in Table 2 (with approximately 10% of your total invested in each stock) and hold each stock until it falls off of Table 2. Then replace the stock you sell with the highest ranked new stock in the table. This strategy will be more volatile than purchasing all the stocks in Table 2, but investment returns should be similar over time.

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[1] Monthly returns for the Model Stock Portfolio for years 2003-2004 represent actual (unleveraged) returns, after all trading costs.

Table 2: Model Stock Portfolio

Rank	Stock	Current Price on 12/31/07	Target Ownership 12/31/07	Required Adjustment	Shares Owned on 12/31/07	Actual $ Ownership 12/31/07	Actual % Ownership 12/31/07
1	HLX	41.5	12.4%		90	$3,735	7.0%
2	PCAP	10.09	10.4%		200	$2,018	3.8%
3	NGPC	15.63	10.3%		220	$3,439	6.5%
4	IOSP	17.16	9.9%		125	$2,145	4.0%
5	PSEC	13.05	9.9%		200	$2,610	4.9%
6	FCX	102.44	9.1%		25	$2,561	4.8%
7	ROSE	19.83	8.3%		180	$3,569	6.7%
8	AOB	11.08	8.0%		165	$1,828	3.4%
9	SUMT	4.75	7.3%		470	$2,233	4.2%
10	AMSF	15.51	7.3%		155	$2,404	4.5%
11	KALU	79.48	7.0%		35	$2,782	5.2%
12	AYR	26.33	0.0%	(85)	0	$0	0.0%
13	CSE	17.59	0.0%	(230)	0	$0	0.0%
14	CVO	17.47	0.0%	(75)	0	$0	0.0%
15	DAL	14.89	0.0%	(125)	0	$0	0.0%
16	HWK	18.02	0.0%	(160)	0	$0	0.0%
17	NTRZ.OB	1.4	0.0%	(1,400)	0	$0	0.0%
18	ZZCASH	1.00	0.0%	14,720	23,871	$23,871	44.9%
			100%			***$53,195***	***100%***

The adjustments to our Model Stock Portfolio this month are shown in Table 2. If you do not have low trading costs (i.e., brokerage commissions), you may wish to forego any incremental adjustments for stocks already in the portfolio. Most of them are made in keeping with our 2% rule where we will buy or sell shares once the "Target Ownership" is greater or less than 2% of the "Actual Ownership."

Asset Allocation Model

Table 3 below shows *The Prudent Investor*'s recommended asset allocation for three model portfolios.[2] These portfolios represent a solid diversified investment strategy for an investor. Suggested mutual funds are listed in the table for you to purchase. However, you may wish to substitute any or all of these funds with other funds of your preference in the same asset class. Most mutual funds within the same asset class (e.g., "Large Cap" class) have very similar returns over longer periods of time.

Note: If you follow the Model Stock Portfolio published in this newsletter each month, you may wish to use one of the Asset Allocation Models below to determine your equity/fixed-income ratio for your overall investment portfolio. Then, instead of purchasing the suggested equity mutual funds given in Table 3, you can merely purchase all the stocks in the Model Stock Portfolio shown in Table 2. This substitution is not a one-to-one match with respect to diversification, but it should be sufficient to give you at least a moderately diversified stock portfolio with attractive upside potential.

<u>Conservative Portfolio:</u>

- **Best For:** This asset allocation is appropriate for investors who are looking to participate in the stock market but who are risk adverse. Investors nearing retirement age may wish to consider this allocation, as well as those saving for college or for a house purchase within five years.

[2] *You may wish to adjust the asset allocation of your portfolio on a quarterly basis rather than monthly. In most cases this will have only a small impact on total returns. This newsletter does not take into consideration the potential tax implications of more frequent rebalancing. For retirement accounts, tax consequences from more frequent trading are not a concern.*

- **Fair Value Allocation:** When the stock market is considered to be at “fair value,” the Conservative Portfolio will have a 60%/40% equity/fixed-income split.
- **Current Allocation:** Based on current market conditions, the suggested equity/fixed-income allocation is 75/25.

Moderate Portfolio:

- **Best For:** Appropriate for investors who are willing to take more risk in the stock market in order to seek a higher long-term total return. Investors who are further from retirement will find this portfolio suitable to their needs. It also is recommended for investors who have under $100,000 to invest in stocks and bonds.
- **Fair Value Allocation:** When the stock market is considered to be at “fair value,” the Moderate Portfolio will have a 75%/25% equity/fixed-income split.
- **Current Allocation:** Based on current market conditions, the suggested equity/fixed-income allocation is 90/10%.

Aggressive Portfolio:

- **Best For:** Appropriate for investors who have a high tolerance for enduring market fluctuations and who seek above-average returns over the long term. Investors who are further from retirement will find this portfolio suitable to their needs. Only investors who have in excess of $100,000 to invest, and who are not close to retirement, should consider this asset allocation.
- **Fair Value Allocation:** When the stock market is considered to be at “fair value,” the Conservative Portfolio will have a 90%/10% equity/fixed-income split.
- **Current Allocation:** Based on current market conditions, the suggested equity/fixed-income allocation is 120%/0%. (A number greater than 100% for equities means the portfolio will be leveraged.)

Table 3: Asset Allocation Models

Category	Mutual Fund Symbol	Mutual Fund Name	Conservative Portfolio "Fair Value" Target	Conservative Portfolio Current Target	Moderate Portfolio "Fair Value" Target	Moderate Portfolio Current Target	Aggressive Portfolio "Fair Value" Target	Aggressive Portfolio Current Target
Percentage in Equities			**60%**	**75%**	**75%**	**90%**	**90%**	**120%**
Large Cap	RSP	Rydex S&P 500 Equal Weight	15.0%	18.7%	18.8%	22.4%	22.5%	29.9%
Mid Cap	VIMSX	Vanguard Mid-Cap Index	12.0%	15.0%	15.0%	18.0%	18.0%	23.9%
Small Cap	VISVX	Vanguard Small-Cap Value Index	18.0%	22.4%	22.5%	26.9%	27.0%	35.9%
REITS	VGSIX	Vanguard REIT Index	6.0%	7.5%	7.5%	9.0%	9.0%	12.0%
International	VEIEX	Vanguard Emerging Markets Index	9.0%	11.2%	11.3%	13.5%	13.5%	17.9%
Percentage in Fixed Income			**40%**	**25%**	**25%**	**10%**	**10%**	**0%**
Long Term Bonds	VBLTX	Vanguard Long-Term Bond Index	10.0%	6.3%	6.3%	2.6%	2.5%	0.0%
Medium Term Govt	VIPSX	Vanguard Inflation-Protected Sec.	20.0%	12.6%	12.5%	5.1%	5.0%	0.0%
High Yield Bonds	VWEHX	Vanguard High-Yield Corp.	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
International Bonds	FNMIX	Fidelity New Markets Income	8.0%	5.0%	5.0%	2.0%	2.0%	0.0%
Cash (Money Market)	VSGBX	Vanguard Short-Term Federal	2.0%	1.3%	1.3%	0.5%	0.5%	0.0%

From the Editor’s Desk

Recession Worries

As we mentioned last month, the “R” word recession is becoming mainstream. It appears that the masses are now accepting its eventual arrival. The funny thing about recessions is that even the experts generally can’t see the start of one until well after we are already in one. It’s actually possible (no predictions here) that we’re currently in a mild recession that may or may not improve over the next several months.

Early January has seen a nervous selloff of stocks already, meaning the normal “January effect” of predictable gains could be in jeopardy for the month. Here is our advice from last month and it bears repeating for emphasis:

> With 10 year Treasury Notes now yielding under 4%, one could argue not that the stock market is cheap, but that Treasury Notes are expensive (giving a correspondingly low yield).
>
> So is it time to buy with gusto or sell and sit on some cash? Our emotions tell us that it may be time to take some money off the table, especially until we can start to see a true bottom to the credit crunch and related deteriorating housing market. When things are the worst, that is the time to jump in as an investor with boldness, because the markets have usually hit bottom at that point. And yet, that is the very hardest time to invest.
>
> As we have said in the past, it’s best to stick to your investment discipline and not try to time the market, even when everyone is so sure that the “r” word is coming. That means continue to take advantage of market dips to add to your investment portfolio. However, now is definitely not the time to take any risk with funds that may be needed in the next one to three years. Park those funds in a good money market and sleep well at night.

Pausing for ‘08

As we have previously mentioned, your editor of *The Prudent Investor* has made no plans to continue the newsletter in 2008. We would prefer to end in the black, but the market disagreed with our decisions over the past few months.

For those of you who currently own one or more stocks in our Model Stock Portfolio and have not yet contacted us, we would like to offer some guidance on when to successfully exit those stocks in 2008. If you would like to receive notice on when to exit the individual stocks in our model, please email info@pruinvestor.com and we will make arrangements with you to keep you informed on when each stock no longer passes our criteria for owning.

Here’s wishing you all the best of investment success in 2008!