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Investment Insights

August 2009

TRAFFIC LIGHTS IN ATLANTA!

Once upon a time, as a new student driver, I was taught to obey traffic lights, to heed their red, amber, and green signals. That was in New Jersey.

Then I moved to Atlanta. *Drivers' behavior when it came to traffic lights, were definitely unique in Atlanta.* For brevity sake I'll relay just a few examples.

Braking for an amber light was normal for me. An amber light for Atlantans, however, evoked a "damn the torpedoes, full speed ahead" reaction. In time, I adjusted my behavior to the Atlanta meaning of amber. Then one day the car ahead of me inconceivably quick stopped at an amber light. My car screeched and skidded right into his rear end. In a split second amber had regained its meaning.

One morning rush hour, I noticed a young woman in the car next to me. She had her sunscreen mirror down, very methodically doing her eyebrows, her lipstick, and powdering her nose oblivious to her green light. She and the honking cars behind her had to sit through another complete cycle of the turn lane light. I'm glad I wasn't in her lane.

Another morning, I stopped behind a car at a red light. On green, the car didn't move. I pulled up next to the car and then saw that the driver had fallen asleep!

You who live in Atlanta probably have traffic light stories of your own. In any case, we probably all agree that traffic lights are necessary for safety and smooth flow of traffic.

In our investment practice we also have traffic lights that are instrumental in managing reward and risk. Without traffic lights we'd have a much more difficult time adhering to our mantra, **Do No Harm and Make Money*** (please read the sidebar). Our investment traffic lights are not perfect but they are very important to help grow and protect assets.

Some of the most important traffic lights are the ones that guide us as to whether, to what extent, and where it makes

sense to invest in the markets. Those markets include stocks, fixed income, domestic and foreign currencies, commodities, and real estate. They are global markets – domestic and international.

For all of these, we have primary and secondary traffic signals that indicate whether we should press on the gas or step on the brake with regard to putting money to work. We also have signals for individual securities.

One example of the value of our traffic lights was a portfolio that transferred in several years ago. Fannie Mae was one of the holdings. The lights were flashing red on the financial sector and also on Fannie Mae. We heeded the signals and liquidated Fannie Mae at about \$60+ per share. As I write this, Fannie Mae is now sitting at \$1.10 a share.

More recent examples were in March when the signal turned green for more exposure to equity investments over cash and bonds. In April a green light flashed for international and emerging market equities, basic materials, and small growth, and within the past month for commodities.

Once in a while our signals go on the blink and the market, or sector, or individual security does the opposite of what our traffic lights are showing. The whip-saw reversal up in the markets in July is an example of that. More often than not, though, and over a market cycle (peak-to-peak or trough-to-trough), the traffic signals prove their value many times over.

For each position in which we're invested we have a target price and a stop-loss price. We install traffic lights for each. In other words we enter action or price points based on our analysis. If the security hits a price point, the traffic light shines at us (via an e-mail notification) to take action. *(continued on next page)*

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S&P 500 Look back

2000	-9.11%
2001	-11.89%
2002	-22.10%
2003	+26.68%
2004	+10.87%
2005	+ 3.00%
2006	+13.62%
2007	+ 3.52%
2008	-38.5%

NASDAQ Look back

2000	-39.18%
2001	-20.78%
2002	-31.25%
2003	+50.76%
2004	+9.14%
2005	-1.4%
2006	+7.87%
2007	+ 9.27%
2008	-40.5%

YTD thru 07/31/09

S&P500	+8.53%
NASDAQ	+20.29%
10/11/2007 HI thru 07/31/09	
S&P500	-36.45%
Mar 2000 HI thru 07/31/09	
NASDAQ	-60.82%

*There is no risk-free investment! Investment portfolio values fluctuate and past performance is never a guarantee of future results. "Do no harm" translates into structuring and managing an investment portfolio to conform to a client's risk tolerance and time horizon.

Proactive asset allocation, diversification within asset classes, and continual monitoring and risk management of each position are methods we use in structuring and managing portfolios. Our approach includes corroborating fundamental research, with capital markets supply-and-demand research, also called technical research. At times we will use conservative hedging techniques to limit downside risk.

(continued)

We may sell, we may invest more money, but in either case we execute and then adjust the lights to reflect the new situation. It's a disciplined process and we use leading edge information technology tools to help us do the analysis and the execution. Even with these productivity tools, managing both the reward side and the risk side of investment portfolios is challenging. We heed and take action, and we continually adjust the lights as conditions change. Falling asleep, putting on a new face, or being otherwise distracted is a definite no-no.

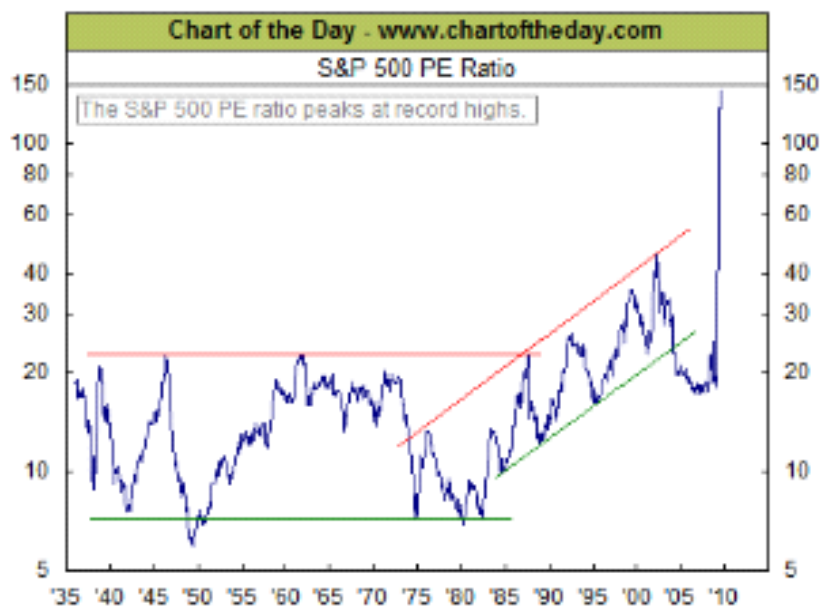
Right now our main supply-and-demand or technical traffic signal is green. We're in wealth accumulation mode. The relative strength in the market remains with international equities and commodities over other asset classes such as fixed income and the money market. One reason for this is a weak dollar. A weak dollar supports higher commodity and international equity prices. Yes, we have traffic lights in place for the dollar. A change in the trend of the dollar could play havoc with investment portfolios.

While our main technical traffic signal is green, the stock market and parts of the commodities markets have risen high and fast. The technical (supply and demand) momentum suggests even more upside. The fundamental picture, however, is not so certain.

Based on our own analysis, we believe fair value for the S&P 500 is in a range from 900 to 1,000. The S&P is above that range right now and irrational exuberance could drive it higher. What about the fundamentals driving the market? Some fundamental economic uncertainties over the next year or two include unemployment, consumer spending capacity, home foreclosures, the direction of the value of the dollar, the federal deficit, inflation, and the honesty, integrity, and competence of public and corporate leadership. Multiply that by all of the economies around the world and it suggests an overabundance of real economic uncertainty and risk both here and abroad.

One basic premise of sound investing is to diversify across asset classes that do not have strong price-movement correlations to one another. For instance, stocks, bonds, commodities, cash, and real estate have historically not been tightly-correlated in their price movements. Recently however, except for cash, those asset classes have become more tightly correlated. That was obvious during the recent meltdown when most all of these asset classes tumbled down together. This convergence of price-movement correlations across asset classes remains a problem. It suggests that having cash (U.S. or a strong foreign currency) is a prudent move. A laddered investment in fixed income securities could also be a prudent diversification step. Laddering is investing in bonds or CD's that have different dates of maturity (e.g. 2 year, 5 year, 10 year maturities). *(continued on next page)*

Look at the S&P 500 Price to Earnings (P/E) chart below. It goes back to 1935. P/E is just one measure of valuation of the stock market. The glaring spike up on the right side of the chart is the result of the recent strong price increase in stocks (P), and the past year's drop in corporate earnings (E). Within the past few weeks that S&P P/E hit a record high of 144 suggesting that stock valuations are historically out of whack on the too-high-side. In turn, that suggests that having some cash or a foreign currency, a non-correlating asset, on the sidelines is a common sense thing to do.



Will another shoe drop? Who knows? No one knows for sure what the market is going to do. The uptrend has generally been powerful since early March. However, there remains a great deal of confusion and uncertainty about economic fundamentals. There will be times in the future when the fundamental economics and investment picture is more clear than it is right now. The technical supply-and-demand picture is pretty clear but a fundamental economic curve ball could turn that technical picture around on a dime. While our technical traffic light is signaling green (though at a higher level of risk), our economic traffic light is signaling amber. It is incumbent on us to pay attention, to stay wide awake, and not to get distracted.