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Investment Insights

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BREAKING OUT

Breaking out: Once upon a time, deployed in the Tonkin Gulf, I was inbound returning from a mission. Flying in thick soup, descending through a cloud layer, outside visibility zero, I was focused on scanning the instruments to get me down and safely back aboard. Then the aircraft broke out of the soup at an altitude of about 500 feet. There she was directly ahead, the USS Enterprise, her angled flight deck, the distinct white centerline, the landing signal officer on the radio talking me down, and her landing system lights brightly beckoning me to land safely aboard. I had broken out, I could see clearly, I was home – what a feeling!

In the investment arena, we also use the term breaking out. It generally means we've moved up through an area of overhead price resistance. For instance if a stock's price has been oscillating back and forth between \$20 and \$30 per share over a period of time, a movement in price to \$31 per share would be a break-out.

Just as in flying, a break out in your investment portfolio value, also feels good. Most would agree that a flaw in this analogy might be that we never really have excellent visibility when it comes to the stock market. We just have periods when the odds are stacked more in our favor to make money than to lose money. A break out is just one sign that the odds might be improving for us to make money.

Shortly after I wrote the March newsletter, signs were showing up that the stock market was beginning to break out. The S&P 500 index on March 17th actually hit a lower low than in January (not good). However, our S&P 500 *supply-demand indicator made a higher low. This was significant.* The supply-demand indicator is a one - stock - one - vote indicator, a better broad market measure than the index itself. The index number that you see on TV over-weights larger companies

and distorts what's really happening in the broader market. On Monday, March 24th, the New York Stock Exchange supply-demand indicator actually turned up and was further corroborated by our world stock indicator also turning up.

To translate, signs were showing up in mid-to-late March that demand was taking back control. Prices were strengthening. We were beginning to see higher bottoms and higher tops in our meaningful indicators. There were still wild fluctuations, but now with an upward rather than a downward bias.

On March 24, as price trends finally began turning from negative to positive, we finally moved back to an offensive posture. That being said, the January through March 2008 quarter was one of the worst quarters in over five years. Also, March closed out a string of five down months in the major US indices. From the October high of 1576 to the March 31 reading of 1323, **the S&P 500 saw a 16% drop in its value.** However the good news is, that **by March 24th, many signs were popping up that suggested we may have begun to break out.**

Our investment management mantra is "**First do no harm and make money**".* (please read the sidebar caveat) Since we were in a defensive or wealth preservation mode during most of the downturn we are now in excellent position to move (and in fact have begun to move) more assets into equity investments. That does not mean there will not be more up-and-down fluctuations. What it does mean is that the risk is much more washed out than earlier this year. The odds are more in our favor to make money in equities going forward.

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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%

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%

YTD thru 3/31/08

S&P500	-9.9%
NASDAQ	-13.9%

10/11/2008 HI thru 3/31/08

S&P500 -16%

Mar 2000 HI thru 3/31/08

NASDAQ -54.9%

*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, that is technical research. At times we will use conservative hedging techniques to limit downside risk.

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There is no telling the timing of the next storm front. The market however does have a tendency to look ahead. Last year as the market began its drawdown, it provided us a good historic "tell" that a slowdown or recession could be expected. Often it is in the throes of the worst pain that the market begins signaling future improvement. I guess it's kind of like passing a kidney stone (personal experience), or giving birth (so I've been told).

My guess, given the supply-and-demand indicators that we watch, is that we'll see a washboard trend up from here. There are no guarantees. More crises could occur that could increase market and sector risk and turn things back down. For the time being though, an increased exposure to equities is the prudent action. And it's nice to have dry powder, and also to have portfolios that are only off a few percent from their highs, rather than down 10, or 14, or 16 per cent.

As you may have read, the Fed took unprecedented action last month to prevent a financial crisis (involving Bear Stearns) from spiraling out of control. There is argument as to what they did, whether they should have done it, and so forth. The fact is we got through that one, and the debate will go on. What storm clouds may lie ahead? Worsening inflation could be a major issue and another crisis-creator going forward. We'll also have to see how the consumer holds up in the headwinds of unemployment, debt, and inflation. Will industry continue investing in capital improvements? Will exports continue to be strong? These are just a few fundamental concerns.

For now, money is flowing thanks to Fed action. Also, strong foreign currencies (a weak dollar) are attracting foreigners to invest in our washed-out market. By doing so, they are getting a double discount on their investments in US companies. These factors favor higher stock prices.

An old adage is that the stock market climbs a wall of worry, and I guess most of us could agree that there's plenty of worry to go around. But as of now we're in make money mode! If the situation changes, be assured we'll be prepared with an effective game plan!

Your feedback and referrals are always welcomed and appreciated.