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Investment Insights

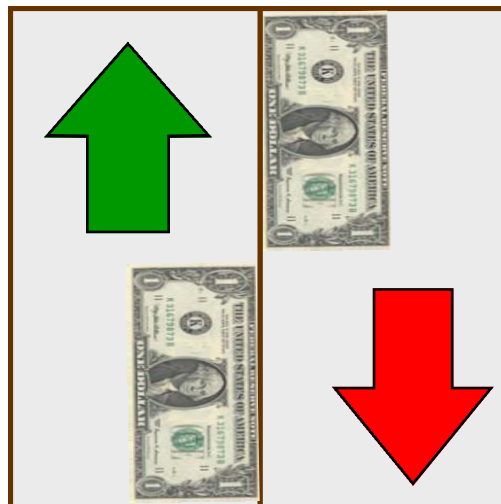
April 2010

STUCK IN AN ELEVATOR

Once upon a time, actually once upon three times, I've been stuck in an elevator. The first time was in Washington D.C. as part of a youth group. I can't remember the hotel but I do remember the sign in the elevator stating the number and weight capacity. It seems we were about twice the number permitted by the code. I also remember everyone piling on including a lot of adults laughing and saying no problem it'll handle us. Well it did till it didn't as it came to a screeching halt mid-floors. We were literally stuffed in there like sardines in a tin. It was extremely hot and stuffy, everyone was pouring sweat, and it took about forty five minutes for them to get us out. We stuck ones talked and joked amongst each other and that helped us get through it OK. Fortunately no one panicked nor did anyone need medical attention which thinking back was kind of amazing.

The other two times were in Atlanta in my own office complex, each time it was off-hours and I was in the elevator alone. One time the office building elevator came to a halt on the way up and I was stuck between floors. The other time I walked on the garage elevator, the door shut, and then it seemed that the elevator smiled at me saying 'now I've got you!' I had my cell phone and was also able to use the emergency communications system for these occurrences. Fortunately, I was not subject to claustrophobia and it was just a matter of having the patience to wait until the elevator technicians could arrive and get me out.

In life, and in the investment markets, our elevators sometimes seem to get stuck and on some occasions might even move in the opposite direction of the way we want to go! That's not always a bad thing but when it happens it can be frustrating and it most always requires patience and prudent actions to get unstuck and heading back in the right direction. It's important at those times to look at things in the perspective of your timeframe which has short, intermediate, and long term horizons.



When the market is moving in one direction or another and a portfolio is 'stuck in the elevator', it's great if the overall market is going down and it's frustrating if the market is going up. No matter what the situation, the underlying reason is that, at these times, the stuck portfolio is not reflective of the market nor will it necessarily track the market. Usually it has to do with the fact that the asset allocation is not aligned with the stock market. In other words, the money may be divided up across six asset classes only two of which are equities, either domestic or international equities. Those other four asset classes include cash or cash equivalents, currencies, fixed income securities, and commodities. If less money is allocated to the stock market and more to one or several of those other asset classes, the portfolio will not track the stock market.

Right now our relative strength research is showing that equities and especially domestic U.S. equities are surpassing all of the other asset classes on a relative price movement basis. However, our level-of-market-risk research, separate and distinct from relative strength, is suggesting that the level of risk in equity investments is very high. Nonetheless, index prices continue to inch ahead climbing the proverbial wall of worry.

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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 03/31/2010

S&P500	+4.64%
NASDAQ	+5.37%

10/11/2007 HI thru 03/31/10

S&P500	-25.27%
Mar 2000 HI thru 03/31/10	
NASDAQ	-52.51%

*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.

Back-dropping the above information, is the fundamental issue of whether or not higher stock prices are sustainable. Will our economic recovery and corporate profit recovery be sustainable in a credit-exacerbated recession? Remember that most of our post-WWII recoveries from recession were supported by a strong expansion of credit. That will probably not be the case this time around. The stimulus money is fueling this recovery and the question arises as to what happens when that stimulus, or the realization that the stimulus, will run out of steam.

Looking under the hood a little further, we note that the big banks continue to be in a smoke and mirrors mode regarding underwater-home-mortgages, and foreclosed or soon-to-be foreclosed homes on their books. The reason that the banks showed so much profit this time around is partly a result of loosey-goosey accounting voodoo. They are presently able to use their own discretion in writing off the bad mortgage-debt on their books. By generously minimizing the dollar amount of their bad debt write downs in their financial statements, presto, the big banks reported super profits. That flies in the face of that bad debt still being on their books with very little idea of how it will eventually be resolved. Banks have the added advantage of course of borrowing at next to nothing and lending, or investing in long bonds, at a high interest rate allowing them to rake in profits on the spread without necessarily adding a whole lot of value to society.

Until more clarification occurs regarding employment and what is happening in the real estate market, we feel the prudent course is to continue to exercise caution. By some long-term market valuation measures, recent market valuations are above the August 1987 and November 1973 market peaks. Current valuations have only been exceeded by those reached in the 2000 dot com bubble, during the 2007 market peak, and at the peak of 1929. All of those just-mentioned years were followed by precipitous market corrections to the downside.

While there are differing points of view and approaches to measuring market valuation we remain on the side of being cautious. The current environment is ripe with bullishness, a high level of technical risk, suspect market valuation, and the specter of rising longer term interest rates. We believe that this combination of ingredients could be dangerous and a good reason to err on the side of caution. No one can foretell the future. We can however do our best to ***Do no harm, and make money**** (please read the sidebar) and to continually work to improve our investment management methodology and our array of research tools.

I think that it is important to keep in mind that wealth is built not so much in pursuing high risk, high returns as it is in avoiding seriously-damaging, hard-to-recover losses. In the next few months, more clarity will emerge in terms of what is happening with regard to the impact of the worst-of-the-worst mortgage resets and also the employment picture. The stimulus and many government programs cannot be sustained and as they subside, a clearer picture will emerge with regard to our investment environment.