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Investment Insights

December 2011

A CHRISTMAS STORY

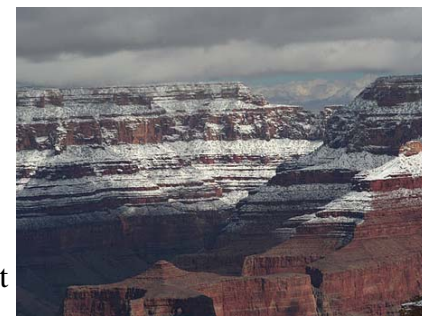
Once upon a time, on a Christmas day, almost immediately after returning from deployment to Vietnam, I was issued new orders to fly from Naval Air Station Imperial Beach (San Diego) to Flagstaff, AZ. Arizona had been immobilized by a freak blizzard. Our mission was to deliver food and medicine and, in some cases, do medical evacuations. We flew into Flagstaff on a clear, cold, bright blue day. My bird was loaded up with Department of Agriculture forty pound burlap bags filled with canned goods and dry food staples. Our operational area was adjacent to the Grand Canyon, an area known as the little grand canyon. Each of us was assigned a sector. We were briefed that if a mirror flashed at us, we were to fly over and drop a bag of food. It sounded easy.

We took off from our improvised staging area and headed out toward our mission sector. We flew above a great expanse of high desert, canyons, and mountains. The landscape below us was breathtakingly beautiful in its brand new Christmas suit of pure white snow. We were at once a witness to, and a subject in, one of Nature's most wondrous works of art. It was truly God's country.

We expected that very few souls would be living in that rugged terrain. Well, we quickly discovered that there were a larger number than expected of Navajo Indians somehow making a life farming and sheep herding. And, to boot, it seemed every one of them had a personal mirror hanging around his neck just waiting for us to fly within eyesight.

We were astonished and literally blinded by mirrors being shined and flickered into our eyes as we flew. It was a **Mirrors, mirrors all around situation**. We were overloaded in an instant, and I shook my head at my original thought that this would be easy. Wrong! Given the impossibility of one single bird responding to all of those mirror signals, my decision was to essentially set up and fly an expanding box pattern. I would drop food to those mirror-flashers who were closest to our flight

path. We had no way to tell whether one mirror signal might reflect more need and distress than another mirror signal. We just did the best we could, and I know we helped at least some of those stranded souls in the middle of God's country.



At one point I landed next to a lone hogan. The Navajo hogan is a primitive, beehive-shaped, mud dwelling. The grandmother in her very colorful outerwear was standing outside. Next to her, sitting on a leather saddle up against the side of their mud residence, was her two-to-three year old granddaughter with big beautiful eyes and raven black hair. She was also bundled up in colorful clothing. On her lap, she embraced a little white lamb. I had decided to debark my helicopter to personally deliver the food and take a picture. Both the little girl and lamb were looking curiously up at me.

That very human moment was *A Christmas Story* still etched in my heart and mind. Not a word was spoken, but the gratitude on the grandmother's face for that burlap bag of food was one of the best Christmas gifts I have ever received. Christ's words "It is more blessed to give than to receive." hit home on that crisp and cold but very warm Christmas Day. The spirit of giving hit home in all of its truthfulness and power!

There are many lessons learned from that Christmas Story mission to my current business of investment management. We'll cover a few in this letter.

Investing presents a similar dilemma to our Mirrors, mirrors all around situation. There are thousands upon thousands of public investments all around the world clamoring for investor money.

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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 11/30/011

S&P500	-1%
NASDAQ	-1.2%

10/11/2007 HI thru 11/30/11

S&P500	-19.7%
March 2000 HI thru 11/30/11	
NASDAQ	-48.11%

**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

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We know, from research and experience that *how we have money diversified across asset classes given market conditions determines more than 90 per cent of portfolio performance*. We also know that *risk, if it goes against a portfolio, can drastically reduce a portfolio's value very quickly*.

We manage with the help of leading edge information management technology that we are continuously developing; we're talking about using very powerful data base systems to give us and our clients an edge in a very complex world of investing.

Use of this technology provides two results. First, it reduces an unmanageable overload of information to something we can work with. Second, it filters out the noise and gives us valuable and actionable information.

We tell the system what information we want to screen for. It then sorts through and gives us what we want. For example, we can tell the system we only want to look at stocks in a certain industry. Also, we can tell it that we only want to see those companies that use conservative accounting techniques, and that have a record of excellent governance by their Board of Directors and top management. There are many other criteria that we also enter but this gives you the idea. Our systems are also pre-programmed to notify us automatically when the investment climate changes in and across asset classes, global markets, and industry sectors.

So with the thousands of investments out there, with **mirrors, mirrors all around**, it is that information management technology that helps, in part, to point us in the direction of those mirrors that will help us the most in protecting and growing our clients' assets. We are at the leading edge in our industry in the technology that we have and that we use, and we are committed to continually improve it.

We break up the capital markets into six major asset classes. Those **six asset classes are cash, domestic equities, international equities, fixed income, commodities, and foreign currencies**. With the exception of cash, within each asset class there are a wide range of investments from which to choose. This is important. For instance, during the Bear Market of 2000 to 2003 only one area of the domestic equity asset class did well and that was small cap value. It is important to have the tools to determine where to be.

Here's how we are doing that and how we have recently improved our process.

Our supply-and-demand research uses two sets of tools.

One set helps us determine the reward vis-a-vis risk in the markets and asset classes that we monitor. In other words, it helps us assess the level of risk in which we are operating.

Briefly if the level of risk is high we want to take a defensive posture. Vice-versa if the expectation of reward is high we want to be in an offensive position.

The second set of tools gives us a continual picture of relative strength across our six asset classes and within our six asset classes.

In short, we have tools to check the relative strength of anything against anything else in the capital markets. This includes markets, sectors, individual securities and asset classes. In a rising market, if an investment increases percentage-wise more than another investment it is showing relative strength. In a falling market, if an investment decreases less than another, percentage wise, it is still showing relative strength over the other since it is decreasing less.

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By including *cash* as one of our six asset classes we can continually monitor the relative strength of the five other asset classes compared to *cash*. If *cash* begins gaining relative strength over other asset classes, it provides us with powerful visibility into reward vis-à-vis risk and that is valuable and actionable investment information. This subtle change of using cash as we continually monitor relative strengths among asset classes, directly and continually helps us to better-manage reward and risk. It is a new corroborative tool that we can now use in conjunction with our conventional supply and demand risk management tools.

In addition to **Supply and Demand Research (technical research)**, we also use **Fundamental Research (macro- and micro-economic research)**. Two of the more valuable fundamental tools that we use daily are our new Insider Transactions research and our Corporate Accounting and Governance research.

While we operate in a mirrors, mirrors all around investment world, we have the technology and analytical tools in place to help determine which mirrors are the most important. It is far better than what I had over Navajo country back on that once upon a time White Christmas day.

We believe that our methodology and our leading edge tools help to position us to be among the best in the industry in preserving and growing our clients' assets over market cycles. (peak-to-peak, trough-to-trough)

At this moment, fundamental global economics is laden with uncertainty. There is probability of recession not only in Europe but also here domestically. Violent swings in the markets have been the norm since the Summer of this year. Technically we remain in wealth accumulation mode emphasizing domestic dividend producing securities and stocks that have high accounting and governance ratings and also that have insiders' buying the shares at market prices. Domestic equities, the dollar, and municipal and certain other bonds are behaving well on a relative strength basis. International equities, gold and the euro are not, in general, a place to be investing at this time.

On behalf of all of the members of our team here at William Baker & Associates, Inc. I wish each of you a Merry Christmas, a safe and very Happy Holiday Season, and a Healthy, Happy, and Prosperous New Year.

Ten Commandments in Preparing for your Future Years ©

William Baker & Associates, Inc.

Do unto others as you would have others do unto you

Your daily practice of this biblical commandment will go far in generating self-respect and also in developing a network of people who in turn respect you. It is one key to happiness throughout your life and applies in your personal as well as your business life.

Develop and strengthen your occupational skills

One of the most important investments in your life will be investing in your own education, experiences, and skill sets for which others have a need and are willing to pay. Improving your usefulness to, and ability to serve others, is your first and most important investment.

Place a priority on your health and fitness

Excellent health and fitness provide you with the wherewithal to work, to play, and to be a more productive member of society. Strive for a good balance in your daily lives that engenders both mental and physical health.

Avoid debt

Debt can quickly become your master. It can destroy your financial wherewithal and security. Be very wary before entering into debt, know that you can meet the terms of the debt, and understand that debt is a special trust and an obligation in cases where you do borrow money.

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Build an emergency liquid reserve

Stuff happens that requires money. Build up three to six months of your annual income, or more, in liquid cash that you can use for emergencies.

Treat money with respect and wisdom

Money is in most cases the fruit of your or someone's (e.g. your parent's) labor, time and life's efforts. Spend it, share it, and save and invest it with care and consideration and an awareness that it represents part of your or someone else's efforts.

Develop and keep up a financial plan

You will live your life over your lifetime and will have a need for an annual flow of money to get you through your lifetime. A financial plan gives you a financial roadmap and financial goal for your future in terms of building your nest egg, and in protecting your financial security throughout your life. It will typically include budgeting, college planning, retirement planning, estate or legacy planning, impact of taxes, saving and investing, and protection against catastrophes using a variety of insurance and risk management techniques.

Regularly set aside part of your income for your future security

Develop a discipline to pay yourself first out of your earned income to build a nest egg for your future. Ten or fifteen per cent of each paycheck wisely invested will see you on the road to financial security. The earlier you start the greater success you will have.

Diversify and monitor your investments

Diversification of your investments is a tried and true way of protecting your financial assets from a single investment going bad. Cash and cash equivalents (e.g. Certificates of Deposit), stocks, fixed income, commodities, currencies, real estate, and collectibles are basic asset classes that you can consider putting your money. Monitor and adjust your investments along the way to help ensure that you will reach your financial goals and get the help of a professional financial advisor to guide your efforts.

Avoid large, hard-to-recover financial losses

Accumulating wealth is not so much chasing after high returns in risky investments, as it is in avoiding large, hard-to-recover losses. When making any substantial financial decision, seek advice from a seasoned and objective professional, and go over the pros and cons. Use insurance to protect against large losses. Avoid making financial decisions based on your emotions and be sure to consider the consequences if things go right or if things go wrong. Remember there is no risk free investment, there is no perfect investment, and anytime that you make an investment decision it will entail compromise.

