



Client Bulletin

William Baker
& Associates, Inc.

400 Galleria Pkwy, Suite 1500 Atlanta, GA 30339 Phone: (770) 956-4073
e-mail: wmbaker@wilbankssecurities.com www.wmbakerinvest.com

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BLIND-SIDED?

The current movie *The Blind Side* is getting good reviews. It refers to the Left Tackle position on a football team being one of the most important positions in football. The reason is that the Left Tackle's job is to keep the quarterback protected on his blind side.

With the tremendous, and what I consider now speculative, bull run in the stock market since the March lows there is reason to be prudent maybe a bit more cautious at these levels. Bullishness is rampant as is always the case toward the top of a cycle. Can it go higher? Yes, it can. Am I disappointed because our portfolios did not participate as I would have liked this year? Yes, I am.



That said, we have been working hard to enhance our risk-managed approach to investing, to do even better in the years ahead. While we have underperformed this year, we generally outperformed well from October 2007 (beginning of the recent Bear Market) through the end of 2008. Our portfolios still, longer term and even with an underperforming 2009, are holding up pretty well on a relative basis over the past few years. The S&P 500 is still down about 30% or so from the 2007 highs.

We have put together a research report with help from our research provider, Dorsey Wright & Associates, Inc. www.dorseywright.com. We've entitled it *Enhanced Portfolio Management using Tactical Asset Allocation*. Anyone who would like to have a copy please send us an e-mail request.

At the bottom of this Client Bulletin is a table showing the performance of six asset classes and a Tactical Portfolio. That Tactical Portfolio basically sums up our enhanced portfolio management approach based on our research. If you look at the right hand column it shows you how well the Tactical Portfolio did cumulatively over the entire period. The individual columns show how the Tactical portfolio did, relative to the other asset classes, over each year.

The good news is that we continually work to be among the best in our industry in terms of investment performance over market cycles (peak-to-peak, trough-to-trough). Currently though I remain concerned about being blindsided in the midst of euphoric bullish market action. Our primary domestic risk management indicator (based on a universe of about 2,700 NYSE stocks) currently has us in a defensive or wealth preservation posture. Our world risk management indicator however (based on about a 20,000 stock universe) shows the opposite. It is in an offensive or wealth accumulation posture. Also, many stocks and indices remain in a positive trend at this time. So, 2009 continues to throw off mixed technical signals. That was the reason for enhancing our portfolio management approach so as to better deal with this kind of a year. As mentioned earlier, you can e-mail us if you would like a copy of that research report.

Getting back to the blind-side theme, below are listed some of my concerns about the probability of the market being blind-sided in the near- to intermediate- term. I'm hoping that there will be enough technical indicator precursors that will provide some early warning to us. In 1987 for instance, there were precursor indicators suggesting that caution was in order, before the Black Monday 22.7% drop in the Dow. For those who heeded the precursors they were somewhat insulated from that crash. There are no guarantees however. We see instances of blind-siding in life on a regular basis and the market is no different. There are however some real fundamental concerns that we should be aware of. Let's call them Left Tackle issues, and maybe by being aware of them we can prepare for and mitigate a blind-side event. *(continued on next page)*

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Stock Market Valuations: A variety of rigorous approaches to valuing the markets are in accord suggesting that the market is overpriced at current levels. This assessment differs with what you may be hearing on TV that markets are undervalued based on what I consider more simplistic metrics and over-optimistic expectations of future earnings. I'll go with the more rigorous approaches that are saying we're overpriced here!

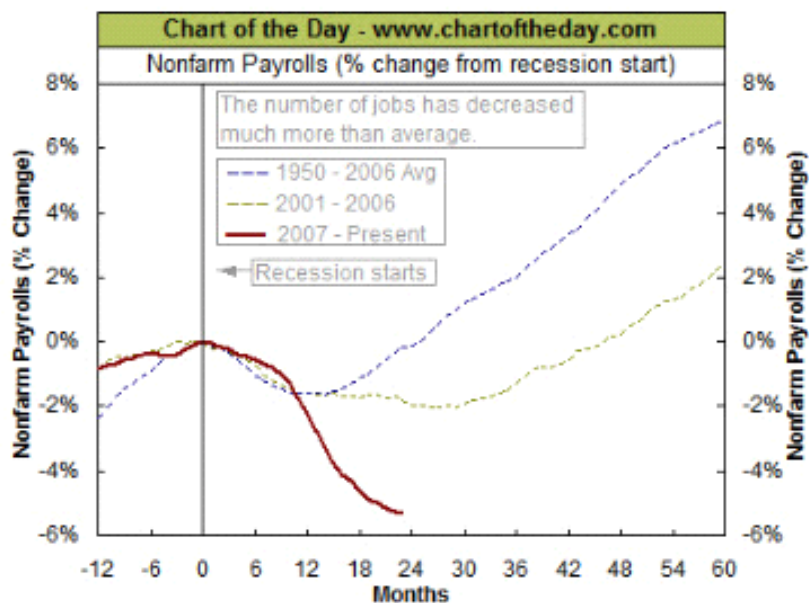
Banks and the Continued Credit Crunch:

Meredith Whitney is a respected banking analyst who forewarned of the credit crisis that caused last year's meltdown. This year, she was generally favorable on bank stocks and she just recently again turned negative. Banks are still in trouble and that trouble will be amplified as 2010 rolls in. FDIC Chair Baird says she expects bank failures to peak next year. The bank and other financial institution problems could well spill over into negative surprises for the stock market. *Tainted assets* with a high probability of getting more tainted as time goes on, *and a requirement on banks in 2010 to use more rigorous accounting procedures*, to move off-balance sheet items back onto the balance sheet, are *two considerable problems that are staring banks in the face*. Many more banks will fail. We'll have to see if it's limited to just a few hundred failed banks or if the situation gets worse than might be expected.

Recovery from normal recessions has always been boosted by an expansion of credit. This has not been a normal recession and credit is still very much locked up for major sectors of our economy, especially smaller businesses that comprise well over half of our employment.

Unemployment:

Our official unemployment is about 10+%. Unemployment, on an unofficial scale however is about 17% or 18%. That bodes ill in the face of a second wave of mortgage resets and of course bodes ill for future housing prices. The below chart compares unemployment in this recession to past recessions. It should drive home the point that what we're going through is worse than normal.



Real Estate:

Foreclosures, being delayed by artificial government intervention, will most likely worsen significantly in 2010. Commercial property financial problems are just beginning. Could we finally see a fire sale of tainted assets by banks? We'll have to wait and see.

Politics:

Any political party in power will, in my estimation, do what it can to look good going into an election. That would mean if the stock market dropped and then began a recovery going into an election it would be positive for the incumbent party. This is not meant to cast aspersions on either party, because I believe that either party would do what it could to look good going into an election. Whether or not the incumbent party has power to move the markets in a timely fashion is questionable. Food for thought though. (continued)

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Personal Observation:

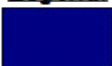
Since March 2009 the market has, with quite a bit of choppiness, climbed a wall of worry to high levels. The S&P 500 is still down about 30% from its 2007 high so it's got a long ways to go to get even. My observation is that we have not seen a significant correction since March of this year. I'm talking about a one-third to one-half retracement to the March lows which would not be a big surprise. We have had quite a few minor pullbacks that were serious enough to throw off false signals but never materialized into a serious retracement. Will we see such a retracement? My guess, and it is just a guess, is that yes we'll likely see a more serious retracement than we have seen so far this year.

A few people have told me that the below table confused them. The table compares investment returns year-to-year, of our Tactical Portfolio of three asset classes, and the six asset classes from which the Tactical Portfolio draws. Notice that they rotate up and down in terms of investment performance from year-to-year. Very important is the fact that the Tactical portfolio is always managing both upside reward and managing risk to protect assets along the way. While not at the top every year the Tactical Portfolio's annual results are very respectable and far surpass the individual asset classes over cycles. That is the main point and that is right in line with our investment management mantra, *Do no harm and make money** (please read footnote)

January 3, 2000 - September 30, 2009

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009 YTD	2000-2009
Tactical Portfolio 49.44%	Fixed Income 8.45%	Commod. 23.04%	Tactical Portfolio 40.43%	Tactical Portfolio 31.37%	Tactical Portfolio 27.44%	Tactical Portfolio 32.80%	Commod. 20.66%	Fixed Income 2.90%	Int'l Stocks 24.89%	Tactical Portfolio 306.26%
Fixed Income 12.22%	Money Market 3.33%	Fixed Income 10.25%	Int'l Stocks 38.12%	Int'l Stocks 17.04%	Commod. 22.54%	Int'l Stocks 25.79%	Foreign Currency 7.67%	Money Market 1.33%	Commod. 18.62%	Commod. 110.83%
Commod. 11.55%	Tactical Portfolio -1.20%	Foreign Currency 9.75%	US Stocks 27.37%	Commod. 11.21%	Int'l Stocks 11.40%	Commod. 13.51%	Int'l Stocks 7.21%	Foreign Currency -10.00%	US Stocks 17.57%	Fixed Income 42.88%
Money Market 5.88%	Foreign Currency -5.33%	Money Market 1.68%	Foreign Currency 14.93%	US Stocks 8.84%	US Stocks 3.65%	US Stocks 13.34%	Tactical Portfolio 4.69%	Tactical Portfolio -10.70%	Tactical Portfolio 15.80%	Money Market 30.01%
Foreign Currency -6.65%	US Stocks -11.77%	Tactical Portfolio -0.57%	Commod. 8.86%	Foreign Currency 6.27%	Money Market 3.01%	Foreign Currency 6.93%	Money Market 4.36%	Commod. -23.74%	Foreign Currency 8.96%	Foreign Currency 21.79%
US Stocks -8.03%	Commod. -16.34%	Int'l Stocks -17.04%	Fixed Income 3.67%	Money Market 1.40%	Fixed Income -1.77%	Money Market 4.73%	US Stocks 3.47%	US Stocks -37.81%	Fixed Income 0.69%	Int'l Stocks -7.95%
Int'l Stocks -15.88%	Int'l Stocks -22.03%	US Stocks -22.53%	Money Market 0.98%	Fixed Income 0.25%	Foreign Currency -7.99%	Fixed Income -0.88%	Fixed Income 1.47%	Int'l Stocks -42.85%	Money Market 0.13%	US Stocks -21.04%

Legend:



The Tactical Portfolio uses a 3 Legged Stool Approach: Domestic Equity Sector Rotation Strategy and 2 highest relative strength Asset Classes among the 6. The six Asset Classes are commodities, foreign currencies, international equities, fixed income, domestic equities, and cash.

- Fixed Income = iShares Barclays Aggregate Bond Fund (AGG)
- Commodities = Continuous Commodity Index (LVM)
- Money Market = DWA Money Market Proxy (MNYMKT)
- Foreign Currency = DWA Foreign Currency Index (DWFAXI)
- US Stocks = iShares S&P 1500 Index Fund (ISI)
- Int'l Stocks = iShares MSCI EAFE Index (EFA)

Hope that the above provides some food for thought in some of the challenges facing us. On some positive final notes, we will get through this difficult economic time. There will be many changes including an overhauled regulatory system, new industry creation, improvements in our education system, infrastructure development, a hopefully-better health care system, and perhaps a move to overhaul our constitution in positive ways. None of this will happen overnight and there are some serious challenges ahead of us.

Please feel free to contact us if you have any questions.

*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 investment objectives, risk tolerance and time horizon. Proactive asset allocation, both diversification across and within asset classes, and continual monitoring and risk management of each position are methods we use in structuring and managing portfolios. Our tactical asset allocation 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.