



Client Bulletin

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SITUATION REPORT

It is our belief that equity markets have been in a bottoming process since collapsing last October and November. Those months' lows were punctuation marks in a Bear Market that began in October 2007. That Bear Market goes on into its sixteenth month as we speak.

A bottoming process, such as this one that started three to four months ago, typically lasts for a month up to a year or more. A year is not a fun prospect to think about since we've already witnessed a sixteen month stock market slide. Hopefully, the bottoming process will end sooner than later. Each market period though is different and you could go nuts listening to what the different experts say.

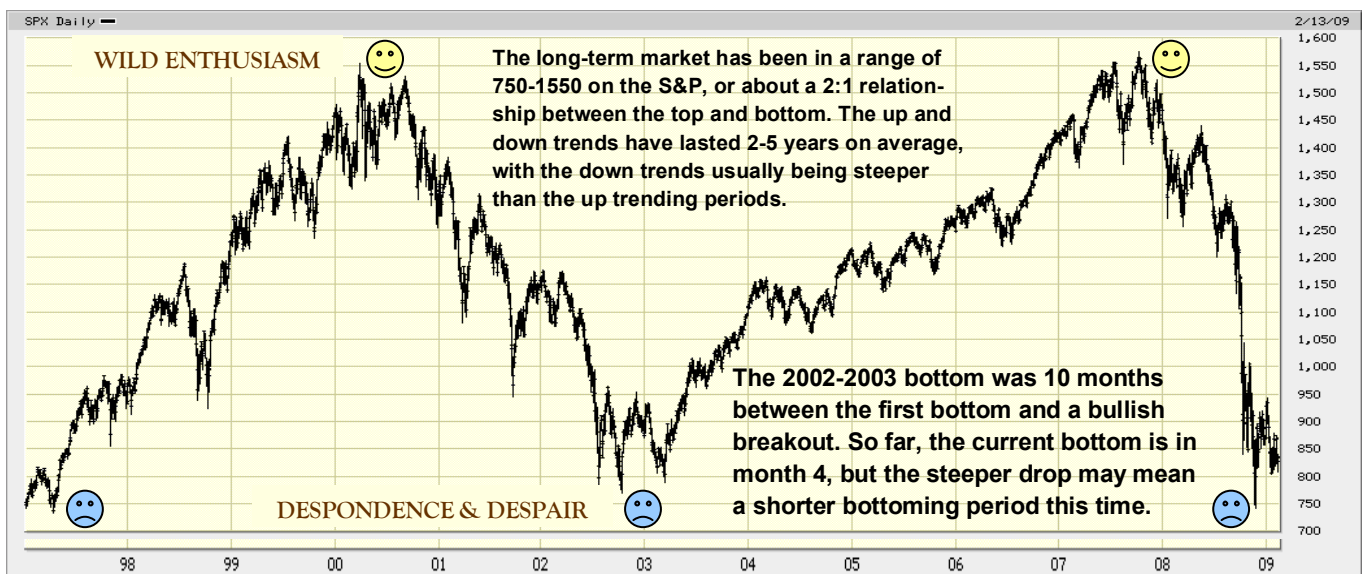
Madoff, Stanley and some of the other recently-exposed ponzi-scheme artists, lured investors in with the idea that they would have safe, consistent, high returns. They lured them in with the idea that they would be in a CD-like investment the annual returns of which would be 8 to 15%. We all know what the final outcome was for those investors. Many, if not all, lost essentially all of their money.

Normal investing is an up-and-down process. It's a marathon, not a hundred yard dash.

Below is a 12 year graph of the S&P500. It drives home the ups-and-downs of investing. It also makes the case to be diversified. Alternative investments such as cash, fixed income or bonds, precious metals, commodities, and real estate are examples of being diversified.

Given the collapse over recent months there have been few good hiding places other than cash equivalents, fixed income, and as of late precious metals. The precious metal sector by the way is another example of the need to diversify. Silver for instance rose about 40% last year and then crashed down close to 55%. Precious metals can move very quickly. You can't time any market sector unless you're very lucky. The volatility of precious metals prices should be another reason – like the ups-and-downs in every other investment class - to suggest to everyone that it makes sense to have a diversified portfolio across different asset classes.

Let's get back to the below S&P 500 graph. The bottom right side of the graph depicts where the S&P500 is in its current cycle. The unknown is whether or not it reverses up from here or whether it falls lower. *(continued)*



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We have a dilemma. A good case can be made that the equity markets will rally from here. A good counter case can be made that the equity markets will fall lower from here. Below are the glass half-full and the glass half-empty cases and some of the main points for each.

GLASS HALF-FULL

While new Dow index lows are being made, they are being made on lower volume.

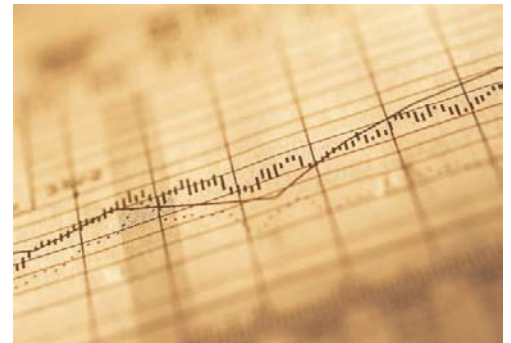
Since last October each time the indices have hit lows there have been a fewer number of stocks that have hit new yearly lows. In terms of supply and demand that suggests that the supply of stocks that investors want to sell is gradually drying up. In other words, individual stocks have held up better than the indices each time the indices have dropped to a new low.

While the DJIA has broken through a support level, the NASDAQ and the S&P have not broken their last year lows.

The fear factor index while historically high is making lower tops and lower bottoms and that is a sign that fear is diminishing from last year.

Basic stock valuations are excellent – our independently-arrived-at fair valuation of about 950 in the S&P and 9,500 in the Dow is significantly higher than where those indices are today.

There is a great deal of money that has fled to cash equivalents, to Treasuries, and to precious metals. Since the annual dividend and interest returns on these instruments are very low or zero, eventually money will move back into equities and that move could mean a very strong move up in prices.



Government is intervening on three fronts; stimulus and jobs, reducing home foreclosures, and bank and credit repair. Government may not get it right at first, but it appears that Obama is willing to adapt, and to surround himself with a diverse group of wise men and women and to listen to them.

GLASS HALF-EMPTY

The markets can and probably will go lower because precious metals, a contra indicator, is in a strong up-trend.

The Dow Industrial and Transport indices have broken new lows. That is a Dow theory signal to sell stocks.

Government intervention can't do anything but make things worse. If there's a way to screw it up, the government will find it.

The economy is going to get worse before it gets better.

Since it took a long time to get into this mess it will take a long time to get out of it and that calls for keeping money out of the stock market in things like cash, bonds, and precious metals.

Basic stock valuations are too high and stock prices have got to come down further. (Note: arguments on whether stock valuations are excellent or horrible can be and are being made by experienced professionals who have different opinions)

Protectionism will keep countries from cooperating to solve what is a global problem. *(continued)*

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After reviewing the above arguments, I think you can see the dilemma regarding what's the best thing to do investment-wise. The right answer is that there's more than one right answer in part depending on a person's financial condition, when they're going to need their investment money, and their emotional risk tolerance.

In spite of using our **Do no harm and make money mantra*** (please read the footnote) as a guideline, the across-asset-class downturn, and it's scope, ferocity, and rapidity, has affected our portfolio values. That effect as you can measure from some of the comparative performance figures in recent newsletters, still puts most of our portfolios in better shape than more than 90 per cent of the professional investment community. Nevertheless our values are down and we remain in a defensive and wealth preservation posture. However, to the extent that our portfolios are in equities, that part of the portfolio has continued to slide in January and February.

At the moment, cash equivalents, the U.S. dollar, some bonds, and precious metals are holding up well. Equities as can be seen from the chart have slid down a lot. A break below the S&P 500 previous low of about 741 would cause us to take more equity losses, and move that money to an asset class not correlated to the stock market, such as a money market. While moving out of equities may seem to be a good idea, at some point equities will reverse up and probably with a vengeance. By moving money out of equities and into cash equivalents, we can lose out by eliminating our participation in a reversal up. So we are committed to doing the best job we can at being prudently diversified and at the same time maintaining some equity exposure.

We continually work every day to be the best in our industry at protecting and growing our clients' assets. We're in a very rough patch. Since the Bear Market started in October 2007, the Dow index downturn over that timeframe is only exceeded by it's downturn over the same timeframe during the great depression. One big difference is that the government sat on its hands in the early 1930's. Government was driven by ideology until FDR was elected. With 25% unemployment and breadlines, FDR effected the New Deal. This time our government and other governments have been relatively quick to intervene. Hopefully that rapid intervention will be coordinated and will work to get things turned around.

To end, I think it's important to let you know that we have the tools and the investment products to put to work across a wide array of asset classes. These include equities or stocks, fixed income securities such as CD's and bonds, a variety of real estate categories, commodities including precious metals, natural gas, energy, agricultural crops, foreign currencies, and other alternative investments. We continually monitor these cross-the-board asset classes in terms of reward and risk and make portfolio adjustments based on our analysis. This downturn has pounded down most all of those asset categories putting a great deal of money on the sidelines in money markets, treasuries, and precious metals. Much of that flight-to-safety money is locked up waiting for the credit markets to get roto-rooted if you will. This unlogging process of the credit markets obviously hasn't yet happened. When it does we believe that we will continue to be in a better position than most to identify the best places to put money back to work.

Please feel free to call with any questions that you may have.

*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.