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Investment Insights

February 2009

HAPPENINGS ON THE HUDSON

Once upon a time, my Uncle Al and his constant fishing buddy, Floyd, took me and his daughter, my cousin Lois, on a fishing trip to the Hudson River. The put-in was at Grassy Point, New York, and our vessel was a 16-foot, old wooden boat to which my Uncle attached his Evinrude outboard. We were loaded down with fishing gear, bait pails, sandwiches, drinks, life preservers, a portable tank of fuel, and Uncle Al and Floyd as well, neither of whom could be described as Twiggy. My cousin Lois and I, both about twelve years old at the time, were the skinny ones.

We got a mid-afternoon start with the idea that fishing at dusk might provide a better catch. Before we fished though, we motored around a large fleet of moored WWII ships. They had been cocooned, mothballed, packed in rows, side-by-side like sardines, perhaps to be reactivated in some future war. Motoring by these retired ships of war, it was as if they were lined up at attention for our review. These gray ghosts, warships of the past, were a very impressive sight for a couple of twelve-year-old kids like us. After our pass and review, we headed out to the channel to begin fishing. Dusk and darkness began to close in.

Everything seemed to happen all of a sudden. The wind and waves began to pick up, a humongous black freighter was steaming down the channel toward us, and Floyd, who was in the stern, suddenly piped up, exclaiming that water was coming over his shoes. Uncle Al shined the flashlight, and sure enough the stern of the boat was filling with the Hudson.* The freighter was bearing down; Uncle Al, Lois, and I were flailing around pulling up the anchor, shifting gear from the stern to the bow, and using our makeshift Clorox scoops to bail out the water. Floyd was at odds trying to get the Evinrude started to get us away from the path of that unrelenting freighter.

Fortune being with us, Floyd managed to start the motor and move us away from the oncoming bow of that freighter. It seemed that there had not been a moment to

spare. Believe me, looking up, at night, at the steep hull of an ocean vessel from the vantage point of an oversized rowboat, after almost being run over by the freighter, is one of those moments that burn into your memory.

What made me think to share the above story with you was the recent and uplifting U.S. Airways story. Captain Sullenburger was the aircraft commander who successfully ditched his Airbus full of passengers into the Hudson River off Manhattan. What a great story to start 2009! It was a testament to the Captain's command, competence, and courage. It was also a testament to the passengers and the many rescuers who came together, in a moment of crisis, and turned a potential tragedy into a miracle. It was for me another example of a happening on the Hudson that could have turned out very differently. Hopefully, the U.S. Airways story will be a prelude to what lies ahead for our country.

As usual, you may be wondering how all of this ties in to your portfolios and the capital markets. For one whose investment management mantra is **First do no harm and make money**** (please read the sidebar caveat), the meltdown since October has been frustrating and challenging. As in that early experience on the Hudson, everything seemed to happen all of a sudden.

The fury of our recession, worsened by the bursting of a credit and housing bubble, challenged, and continues to challenge, all of the investment skills and tools we have. When that ship, let's call her the USS Meltdown, barreled down on us last October and November, it required that those of us in its way take action. In our very small boat, we weighed anchor, shifted ballast, bailed, donned life preservers. We did our best to get the heck out of the way of this U.S.-made-and-run ship that was wreaking damage on everyday, honest, hardworking people around the world.

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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 01/31/09

S&P500	-8.5%
NASDAQ	-6.4%

10/11/2007 HI thru 01/31/09

S&P500	-46.8%
Mar 2000 HI thru 01/31/09	
NASDAQ	-46.7%

*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

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From an investment management standpoint, our typically reliable market indicators were being tossed every which way by the tumult. Ongoing as it is, when the imminent danger is finally over, I believe that our clients will have come out of it afloat and better than ever prepared to effect a strong recovery. January 2009 statement values in general will be down. After a few initial up days, the S&P whipsawed down and ended the month minus 8.5%. Since its October 2007 high the S&P 500 is now down about 48%.

Currently, a wide range of diversified mutual fund portfolios are generally still minus 30 to minus 50 per cent since the October 2007 highs. The domestic mutual fund stock manager of the year for 2008, chosen by Morningstar www.morningstar.com, was down 19.6% for 2008 (note: minus 33.5% was the average for comparable funds). However, from his high in 2007 he was down about 28.6%. The international stock managers of the year, were down 30.1% for 2008 (note: minus 47% was the average for comparable funds). They are minus 36.7% from their 2007 highs. Our accounts generally are doing better on a relative basis. Part of the reason for that, is that our accounts were generally increasing in value during the first six months of the Bear Market which started in October 2007. In short, I believe that our methodology, tools, and discipline provide our clients significant advantage, and provide a head start to get even and again begin making money, as the market recovers.

Recently I've talked a lot about a bottoming process. That is where we are. Could the stock market move significantly lower? Yes, that is a possibility. Could the market move significantly higher? Yes, that too is a possibility. I figure a fair valuation for the S&P 500 is about 950, and for the DJIA about 9500 – both those numbers are higher than where the indices are today. I calculated those fair valuations independently by extrapolating forward from about 45 years ago when the DJIA was hovering between 700 and 800. I've seen a few other investment strategists also come up with similar figures as a fair market valuation. In the short term though, we all know that the market can be very fickle and move to unexpected lows or unexpected highs depending on the collective sentiment of investors.

In the last bulletin I mentioned that during FDR's first 100 days in 1933 the market moved up about 75%; actually it was closer to 80%. Do I expect anything like that to happen in the first 100 days of the Obama administration? I don't have any expectations. We're due for a rally; valuations are excellent, coordinated government actions are at work to create jobs and shore up the global financial system. However, the world is in a real economic and financial mess, uncertainty reigns, and no one can predict with clarity and confidence what will happen in the short term. My hope is that the steps that governments take in the weeks ahead may well bolster confidence. If the enormous amount of money in money markets and treasuries flow back to the equity markets, we could see a pretty decent rally. I think that is a realistic probability if investor sentiment turns positive. Longer term, however, given a belief that the country will get headed back in a generally right direction, I do think that there will be a significant comeback in this market with emphasis on a longer term perspective. (continued on next page)

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Please look at the below graph. It dates back almost 200 years to 1810, and it shows rolling 10-year average annual returns for U.S. equities. The overall average annual return is 8.4%. What's a rolling 10-year average? An example of rolling ten year averages would be an average annual return based on the ten years from 1997 to 2007 and then an average based on 1998 to 2008 and so on and so on. This chart figures these rolling ten-year averages starting back in 1810.



Source: Global Financial Data

Look at the right end of the graph, where it slopes way down to below the dark line; that's December 31, 2008. **The 10 year period ending last month, December 31, 2008, resulted in a record low average rate of return of minus 1.5%.** The previous record low was back in a depression year, **1938**, when the average annual return for the previous ten years was **minus 1.3%**. Looking back at every point when the market returned less than an average of 2.5% per year for 10 years, it then returned an average of 13.3% over the next 10 years, with a range of 7.1% to 18.6%. ***

Right now, everyone is experiencing pain; some more than others, and the feeling of many is to flee the equity markets. And the fact is that downside risk still exists. It always exists. Also, however, we may be at the point where more risk exists in not being invested in equities. There are lots of opinions out there, but, since no one can see the future, no one really knows. My judgment is that many stock valuations are excellent, but the bottoming process goes on, and that investments in equities are a wise decision so long as we understand and can live with the short term ups-and-downs.

I'd like to close by referring back to the qualities exemplified by Captain Sullenburger and all of those who were victims and rescuers in the U.S. Airways incident. We need to see much more of this kind of positive behavior exhibited at all levels, and especially at top levels of government and the private sector. Fortunately, internet technology will facilitate and promote better governance and stewardship simply through better visibility into what is going on. Input and feedback from individual citizens to corporations, associations, and government entities will become more prevalent and easier to accomplish. We will see the public demanding higher standards in government and corporations to serve their employees, the public, and their shareholders; higher standards such as those that shone through during that U.S. Airways Happening on the Hudson.

As always, we continually work to be the best in our industry at growing and protecting our clients' assets. Please let us know if you think of anyone who would appreciate our services.

* It turned out that the transom of our old wooden boat had a horizontal crack in it. With all of the weight in the stern, the Hudson river flowed in through that crack in the transom temporarily putting us in a perilous situation that we managed to get through OK.

*** The text describing the graph was paraphrased from a recent Dorsey Wright & Associates, Inc. report. www.dorseywright.com
Also, it should always be remembered that past performance is no guarantee of future results.