

# William Baker

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## Investment Insights

January 2009

### Tomorrow

Once upon a time, my wife and I were driving cross-country from Fredericksburg, Virginia to Seattle, Washington. It was the month of June, and we were driving on Interstate 94 west of Bismarck, ND. It was a country where the jack rabbits and gophers far exceed the human population. It was just us, in our Dodge van, the single, straight-as-an-arrow highway, prairie as far as the eye could see, and a darkening sky. We turned on the radio and listened as tornado warnings were being issued. The sky darkened even more, heavy rain started beating down on us, the wind was gusting against the van, and then hail stones began thumping us. The skies all around us were now dark and black. Yes, we were scared.

There was no place to take refuge. I remember saying to my wife, "We just gotta keep goin and get to the other side of this." We hunkered down, kept driving, sweating, and praying. The wind was buffeting us pretty bad, and the hail on our roof and windshield was deafening. Then, all of a sudden the hail stopped, and we both noticed the sky getting a shade lighter. It continued to lighten and finally we saw blue sky and sunshine ahead. Alleluia, we made it through! We later heard that there had been three tornadoes in our vicinity, and we felt blessed and lucky.

One of my favorite songs is *Tomorrow* (music by Charles Strouse, lyrics by Martin Charmin) from the 1977 Broadway show *Annie*. The starting lyrics go, "*The sun'll come out tomorrow, Bet your bottom dollar that tomorrow there'll be sun.....*" At times, during rough times such as last year, 2008, we just have to deal with the circumstances, continue doing the best we can do, keep smiling, and remember that "*tomorrow there'll be sun.*" In the business of investing, we also have to smile and realize that we don't know exactly when *Tomorrow*, at least the *Tomorrow* we're looking for, will come.

How long will it take to get the capital markets moving back in our favor? Well, as I mentioned last month, a positive puzzle was slowly shaping up. After sending out our last Bulletin, the market's volatility index (fear factor index) broke down below its uptrend. It had hit historic

highs in October and November. This December drop in the fear factor index was a positive sign that I had been watching for and was very happy to see. It will hopefully translate into our seeing less violent price moves, and into a basing of market prices that will eventually lead to a future long-term uptrend in the equity markets.

Typically, this basing period that started in October 2008 can take six months to a year or more. Some studies I've recently seen, suggest that the bottom of this recession could occur later this year in the U.S. If so, market recovery and improvement in portfolio values, as a leading indicator, may happen within the first half of 2009. I hope so but there are no guarantees!

What I do know is that right now, supply-and-demand indicators suggest that demand or the potential for higher prices is gaining strength. To keep this going, however, requires a collective expectation that the right steps are being taken to fix the financial crisis and the economy.

These right steps require that political, corporate, and labor leadership do a reasonably good job at getting our country turned around with jobs, new-technology and value-adding industries, a much-improved education system, and a renewed infrastructure (physical, information, and regulatory). As those things begin happening, we should expect very strong capital market growth in the years ahead. It's a tall order, but I believe that is the direction in which we are heading. I should also mention that our healthcare system, the way it's presently set up, puts the burden on business to provide healthcare to workers. That hurts our companies from a global competitive position. Overseas companies don't have to deal with healthcare costs.

Hopefully we'll be able to fix this healthcare and medical insurance dilemma and still maintain our leadership role in the global pharma, biotech, and healthcare sectors. On the bright side we certainly have plenty of problems to solve and things to fix, and that could translate into training programs and jobs to solve and fix them. (continued on next page)

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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 12/31/08

S&P500	-38.5%
NASDAQ	-40.5%

10/11/2007 HI thru 12/31/08

S&P500	-41.9%
Mar 2000 HI thru 12/31/08	
NASDAQ	-43.1%

\*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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Fear of investments remains widespread, but is subdued from the October and November 2008 panic. Also, a great deal of money has been pulled or forced out of the equity markets and moved to Treasuries and Money Markets. Treasuries are probably one of the most overpriced investments at this juncture. Money markets also don't provide much return. Money in Treasuries and Money Markets will at some point flow back into stocks and bonds as people begin feeling safer and again begin looking for better returns on their money. Stocks, for instance, have been smashed down to valuations that are extremely attractive and represent excellent growth in the years ahead. Also, there are fabulous opportunities now for both high dividends from stocks as well as future growth in stock prices. For instance, a basket of emerging market stocks is generating double-digit dividends. In addition, emerging markets will continue to grow at a faster rate, and their stocks offer excellent capital growth in the years ahead. Opportunities like these, and there are many more, including areas of the fixed income markets, occur only a few times in our lives. A key is to capitalize on these opportunities before they evaporate.

Let's review some 2008 statistics and then discuss what's happening right now in the markets.

In 2008: the S&P500 index was down minus 38.5%. U.S. mutual funds, minus 36.0%; and international funds, minus 45.7%. Emerging market funds were down minus 54.7%. Domestic asset allocation funds, or funds of funds, were minus 28.8%; international asset allocation funds, minus 28.0%. U.S. balanced funds ended 2008 minus 25.8%; global balanced funds were minus 28.9%. These balanced funds, considered more conservative, typically have a 60% equity and 40% fixed income split. Looking across this wide array of performance numbers, there's no doubt that capital market performance was abysmal in 2008!

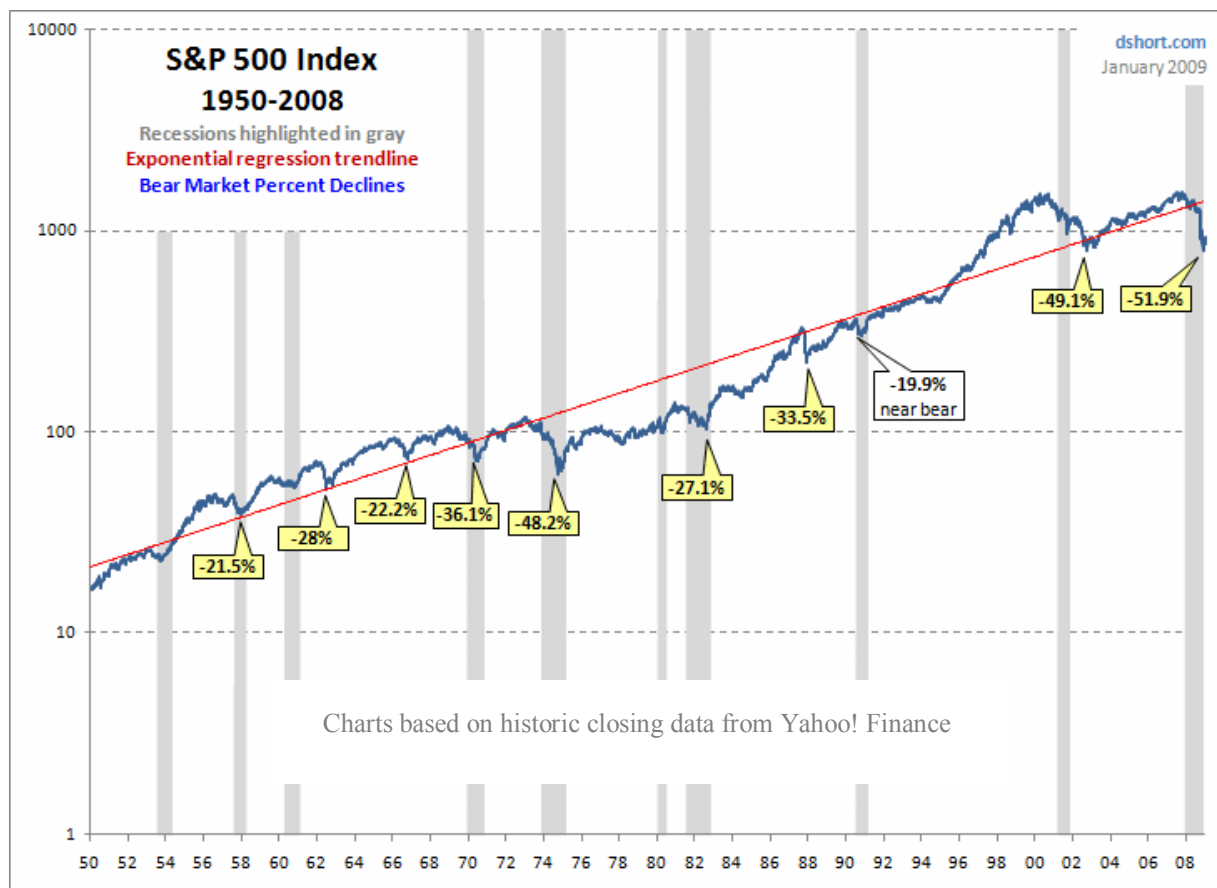
Last year the U.S. dollar began trending up relative to foreign currencies, but in December 2008, it reversed back down, and then within the past week or so, back up. The Fed is printing lots of money to deal with the current crisis and we all know how low interest rates have gotten. If the dollar weakens that will tend to strengthen commodities, gold, and overseas investments. In 2008, as the dollar strengthened, overseas investments fared worse than domestic investments. At this point, with the dollar beginning to weaken, that phenomenon has reversed back to favor international equities. Large global U.S. companies having overseas businesses will also benefit from a weakening dollar. A clear direction in the dollar affects our investment strategy. For this reason, we obviously have to and do keep a keen eye on what the dollar is doing relative to other currencies. Right now that picture is unclear.

Large capitalization stocks are currently turning in the best performance. We also particularly like consumer staples, utilities, healthcare and biotech, emerging markets, gold, and certain fixed income securities. As a basic theme, we prefer to be in equity securities that are generating dividends. Most of you have seen us making changes in your portfolios over the past month or so. This reflects the work we've been doing, and adjustments we've been making, to best position portfolios for the period ahead. Our portfolios already have a head start over most to recover on the upside, and we will do our best to keep it that way, in line with our investment management mantra ***First do no harm and Make money.***\* (continued on next page)

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Below is a graph of the S&P 500, from [www.dshort.com](http://www.dshort.com), going back to 1950. The vertical gray bars highlight past recessions. The encapsulated percentages indicate Bear market S&P declines since 1950. If you look to the right side of the chart, you will see the gray vertical bar indicating our current recession. Also, you'll see that the S&P500 has cycled down (with a -51.9% decline from the October 2007 high). With all of the positive supply-and-demand signs popping up, my expectation, with no guarantees, is that we'll soon begin seeing a turn up in the below S&P chart.

### Bear Bottoming Process



Our team works continually, every day to be the best in our industry in protecting and growing our clients' assets. Please contact us with any questions or referrals of individuals who would appreciate having their assets continually monitored and adjusted, given ever-changing market reward- and risk conditions. Please feel free to share this newsletter and our website address <http://www.wmbakerinvest.com/>

Best wishes for the new year.