

# William Baker

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## Investment Insights

July 2008

### MEN IN BLACK SUITS

Once upon a time, not too many years ago, I walked into our bank in Fredericksburg, VA. It was Friday evening near closing. This is the exact day and time that what you're about to read, on the rare occasion that it occurs, will normally take place.

It was a tiny little bank which made the experience all the more strange. I was simply there to make a routine deposit to our joint account. You may remember a time when you found yourself in the middle of something that sent chills through you. This was one of those moments, an-out-of-the-ordinary, really-weird, spine-chilling moment

As I entered the bank, I found myself amongst a swarm of **men in black suits**, about a half dozen or so. Fredericksburg, VA, is a casual, small town place. It is not Washington, D.C. These men in black suits did not acknowledge my presence. They said nothing. They wore faces that were set without expression. They were dressed so gravely, they were so out of context, that they sent shivers through me. They made my hair stand on end. Whatever was happening felt like the Twilight Zone. The men moved with an air of competence and confidence. These uniform men in their uniform black suits were completely and uniformly focused. They knew exactly what they were doing, and they were getting done whatever it was that they were doing. And whatever it was, I was in the middle of it!

I approached the bank teller and, in a very low whisper, asked the woman behind the window, "What's happening?" As I asked the question she looked at me with a pained and contorted expression. She then burst into tears. After a moment she regained some composure and went on haltingly, in a sobbing voice, to tell me that these men were there to take control of the bank. It was a failed bank. It turned out that these men in black suits were the executioners acting at the authority of the Comptroller of Currency and the Federal Deposit Insurance Corporation (FDIC). They were charged with

taking control of the bank's assets, liabilities, and all of its records and operations. And the best time for them to do that was at the end of the week, right before closing.

Upon hearing the teller's words, everything fell into place. A sense of relief and reality actually washed back over me. The men in black suits now made sense to me. At that moment, I remembered in the recesses of my brain that I had read or had heard about this process somewhere along the line, during my formal education. Since I had less than \$100,000 deposited with the bank, I was unconcerned for my money because I knew that the FDIC would protect it.

When a bank's assets and liabilities are out of whack, and if and when the regulators catch it, the FDIC role is well-thought-out and very orderly. The bank's assets, liabilities, accounts, and operations are taken over by the FDIC. FDIC-insured deposits are protected. Then the failed bank's accounts, assets and liabilities are normally turned over to another bank. That bank is paid to take over and clear up the remaining mess. **The Men in Black Suits, it turns out, are the good guys!** The underlying reasons, and how the bad guys got away with causing the bank's failure, are an entirely separate issue. The point for emphasis is that the FDIC men in black suits, the protectors of our bank deposits, and our banking system, are the good guys!

As an aside, in 1988 and 1989, more than 1,000 U.S. banks and thrifts failed. Right now, those men in black suits, some long-retired, are being asked to come out of retirement. Why? To help handle what will be a spike up in bank failures in the near future. Only three banks failed in 2007, but current estimates suggest that upcoming bank failures will be in the hundreds. If that holds true, it still portends a better picture than in 1988 and 1989.

*(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%

### 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%
YTD thru 6/30/08	
S&P500	-12.8%
NASDAQ	-13.5%
10/11/2007 HI thru 6/30/08	
S&P500	-18.8%
Mar 2000 HI thru 6/30/08	
NASDAQ	-54.6%

\*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, that is technical research. At times we will use conservative hedging techniques to limit downside risk.

(continued...)

What does all this have to do with your investment portfolios and our disciplined investment methodology? Let's see if we can tie it together. What sparked my memory of **Men in Black Suits** was a recent headline that June was the worst month in the Dow Jones Industrial Average since 1930. The 1930's were before my time, but we know about the New Deal and the government policies and regulations that came out of those years. The above story in fact had its genesis in the Banking Acts of 1932 and 1935. Those Acts in part were meant to protect depositors and society at-large. In the above story the men in black suits were doing their job. They were protecting depositors, and also in a broader sense *insuring domestic tranquility and promoting the general welfare!*

Let's face it, our checks-and-balances have gotten watered down to where investors often can't rely on fundamental information alone to make good investment decisions. They might think Bear Stearns, Citigroup, or whatever is a good solid brand name. Dividends are good and such-and-such a company will be around forever! Well if appropriate regulatory checks-and-balances are weakened by underfunding, understaffing, incompetence, or by authorities turning a blind eye to obvious problems, guess what happens. Crashes happen. The good guys get hurt is what happens!

If appropriate regulation does not even exist - as in areas of investment banking and hedge fund activities - crashes also happen and the good guys are again hurt. Estimates are that some investment banks were leveraged 35 to 40 times in the recent and ongoing sub-prime mortgage mess. That's unchecked capitalism, that's an absence of prudent stewardship, that's a lack of leadership at many levels. That's free enterprise not at its finest hour! That's the bad face of unbridled free enterprise that can and will mislead and hurt investors and other good guys!

In keeping with our mantra, "**Do no harm and make money.**"\* (please read the sidebar) we have managed to avoid most of the stock market damage done in June, and really since October, 2007. In most cases we've made money over that time frame, and in other cases, we've minimized the downside to a few percent. The major indices, as you may know, are now in Bear Market territory which means they are down more than 20% from their highs of last year (S&P 500 -20.6% at close on 7/7/08). Having money on the sidelines gives us plenty of room to take advantage of new investment opportunities as they arise in a much-lower-risk investment environment at some time in the future.

How have we done that? In short, we place emphasis on daily due diligence and execution, within a framework of very disciplined risk management. To put that in English, we monitor the markets and our accounts daily and make adjustments as required. We invest in securities that are in established up trends, and show price strength over and above their peer group and the broad market. When market risk is high as it is now we reduce market exposure and move assets to the money market and other areas that do not correlate with movement in the stock market. Examples include foreign currencies, fixed income securities, commodities, and real estate. The latter are also required to pass muster in terms of their reward-to-risk situation before we invest. For now, we remain on the defensive and in a good cash position to take advantage of opportunities as they arise in a lower risk environment sometime ahead.

Thank you for your interest, support, feedback, and referrals. We always look forward to serving you and to hearing from you! Have a great month of July!