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Investment Insights

July 2009

BULL S... THERE'S A SHARK DOWN THERE!

Once upon a time, I took my son on a SCUBA vacation. We had chartered, as part of a group, with Blackbeard's Cruises out of Miami. We boarded the sailing catamaran and found ourselves headed for the waters off of Bimini. All week we dove and listened to Jimmy Buffet music recordings. It was a really great vacation with one very memorable moment!

All of our dives were made from a stern dive platform which had a ladder going down into the water. We then used that ladder to get back aboard at dive's end. The boat's dive master was strict. One rule he laid down was that upon return, only one person could be on that ladder at a time. That was his very strict safety precaution and that was that!

A few days into the cruise they scheduled a night dive. I decided to take a break on that night and enjoy the moon and stars and melodies of Jimmy Buffet. All of a sudden my peaceful reverie was shattered with the dive master screaming loudly down at the dive platform. "**ONLY ONE PERSON ON THE LADDER AT A TIME!**" It sounded pretty serious, like whoever the offender was, would at the least be keel hauled at dawn. I was glad it wasn't me!

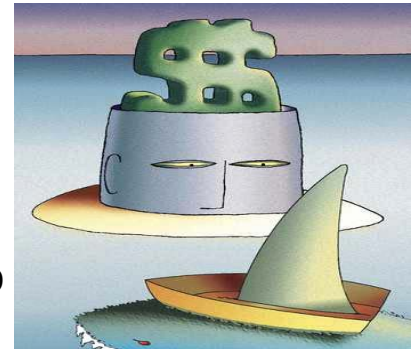
Well from the title you may have guessed it. Sure enough the second diver scrambling up the ladder as fast he could right on the heels (or flippers) of the diver directly above him out-screamed and overrode our dive master by several octaves: "**BULL S... , THERE'S A SHARK DOWN THERE!**"

Given the circumstances, the dive master reluctantly decided to overlook the gross disregard for rules by the hapless and frightened diver. The eight foot shark down there trumped the dive master's rule. The dive master actually acknowledged that his hard and fast rule of only one person on the ladder at a time didn't hold this time.

I'm still glad that I didn't dive that night!

In mid-June you received our bulletin *Having a Game*

Plan which relayed that our supply-and-demand indicators had put us in a defensive posture, or in a wealth preservation mode. I am writing this newsletter on July 21st. On July 8th, the S&P 500 broke down through an 880 floor with our risk indicators showing a higher level of risk. We estimated initial downside risk as more than 15% if that scenario played out. Then, in almost a blink of the eye, the S&P whip-sawed up to the 950's. This rapid move up has been strong enough to put us back into wealth accumulation mode. We often use the expression that it is better to lose opportunity than to lose money. We will adhere to that discipline because we know that it works well over time.



Investing of any kind involves risk. There are always sharks down there, but you often don't see them. There are also sharks that will hurt us and sharks that are harmless. The dive master I discussed earlier kind of made fun of the rest of the divers as they popped like corks to the surface. He was telling them that it was probably just a harmless nurse shark. Of course he showed no inclination to jump in himself to go down and verify that. None of the surface-popping divers had the expertise to identify the threat level of that particular shark. To them, an eight foot shark was an eight foot shark, and that was that.

We use supply-and-demand research corroborated with fundamental research to determine market, sector, and individual security risk. Those two bodies of research help us assess, if you will, the danger of sharks – or the level of risk we are dealing with in terms of our investments. That level of risk was very high a few weeks ago and is now much lower. *(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 06/30/09

| | |
|-----------------------------|---------|
| S&P500 | +1.78% |
| NASDAQ | +14.06% |
| 10/11/2007 HI thru 06/30/09 | |
| S&P500 | -40.84% |
| Mar 2000 HI thru 06/30/09 | |
| NASDAQ | -63.66% |

*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.

(continued)

What happened? Since *Having a Game Plan* was sent out, and up until last week, we actually had additional market deterioration confirmations of our defensive posture. However, in just a few days, we began to see some reversals up in a few indicators. On Monday six per cent of stocks on the New York Stock Exchange were on new buy signals. That signaled, in accordance with our discipline, that we move from a wealth preservation to a wealth accumulation mode. In keeping with our story, the sharks down there are no longer presenting as much danger (the danger was 15% or more downside—very significant) as they were earlier this month. That could change anytime but for now we'll execute our game plan to increase our exposure to the market. Even while we do that, let's talk about some of the sharks that remain lurking out there as we move back to offensive plays.



The fundamental economic picture, while better than it was at the end of 2008, still remains murky. Government has taken a lot of actions. There are many experts supporting those government actions. There are also many other experts voicing totally opposite views as to the soundness of government policy. Some of our fundamental concerns follow. *They center around the employment picture.*

Consumers, in general, remain up to their eyeballs in debt. We have a continuing decline in housing prices, we know we have another wave of mortgage debt coming due, and we have concerns that unemployment may continue to worsen. In past recessions, unemployment was a lagging indicator. In other words, even as unemployment got worse, the economy began to improve. In this recession, unemployment could well be a leading indicator. That means that if unemployment continues to worsen, it could be a precursor to a worsening economy because of more defaults on debt, home foreclosures, lower home prices, more credit crunches, and a further deterioration in consumer spending. The concern is whether or not government policies are, and will be, sound, will work, and will prime the private-sector pump enough to turn around the unemployment situation and get the economy back on track. There are other sharks such as the increasing federal deficit and possibility of higher interest rates, but the unemployment, real estate, debt, and deteriorating consumer spending shark (or sharks) is, we believe, the significant and observable risk that we may face ahead.

The S&P 500 remains range bound between about 870 and 950 and the question is will it gain legs and push beyond the 950's with the offensive team now on the field. The major stock indices rebounded 35% or more from the early March lows through the end of May. On June 12th, that rebound ran out of steam, supply took control and put us in a defensive, wealth preservation posture. After further market deterioration, in a blink of an eye the market rallied up to the top of its trading band and has now put us back into a wealth accumulation phase. It's been a very choppy period.

Our current investment posture follows. At the top level, foreign equities (especially emerging markets) and the money market are our two favored asset classes. At an industry or a sector level, technology, basic materials, consumer cyclicals, and financials are showing relative strength. We continue to keep a small position in precious metals. Strength in the mutual fund universe, in addition to all of those sectors just mentioned, is currently favoring small cap growth. Given the recent change to an offensive posture we will begin increasing our investments in these areas.

Adhering to our mantra of **Do no harm, make money*** (please read the sidebar) we adjust our investments in a very disciplined and proactive manner as the reward-risk situation changes. That reward-risk situation changed on Monday of this week.