

# William Baker

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## Investment Insights

July 2010

### MOUNTAIN CLIMBING, HIKING, AND SUMMITTING

Once upon a time I did a lot of hiking in the Appalachian Mountains and a little hiking out west in the Sangre de Cristo mountain range. A few times, I with friends would pick out a random mountain top. We'd then make our own trail to get to the top. Memories of those grueling, trail blazing mountain hikes include lots of ups-and-downs, many switchbacks, at times very beautiful mountain streams and waterfalls, and a great deal of pleasure upon summiting, achieving our goal of getting to the top of the mountain. The view from the mountain top was always beautiful. We looked over at other mountaintops, looked down on the valleys, and rivers, and lakes, and up at the blue sky with white cumulus clouds and an occasional soaring hawk. Being there put you in perspective. Those views made that tortuous, hard-working, sweaty trek up the mountain worth it.

We chose nice days, were well equipped, and were prepared for changes in weather. While somewhat arduous, those mountain climbing hikes were by no means extreme or dangerous. There were always risks of a fall or a sprain but very little risk of something happening that could not be handled if we did not do anything foolish. As all of you know, more extreme mountain climbing, hiking, and summiting can be a very different story. On the one hand the self-fulfillment of a successful extreme climb is perhaps at an emotionally-higher-high-level for the climber. On the other hand, the inherent risks and danger involved are also at a higher level. Injuries, fatalities, and failures to summit, in extreme climbing are rather commonplace.

Investing has many similarities to mountain climbing, hiking, and summiting. Rather than going over all of them, let's take a look at the current capital markets environment that we're dealing with and draw some similarities.

Within the past few weeks I put out a client bulletin entitled *The Death Cross*. It stated that one of our main technical indicators had just signaled caution, and in so doing aligned itself with a number of other indicators signaling caution regarding equity or stock investments. Well that's

changed! With recent strength in the stock market, our primary indicator along with a few other indicators have see-sawed from negative back to positive. This kind of back-and-forth in our investment indicators is kind of like the ups-and-downs and switchbacks experienced in hiking the mountains. What do you do? You adjust, deal with it, and go on.

Specifically, our main supply-and-demand indicator along with some secondary indicators are suggesting that the recent rise in stock market prices have put demand back in control. Another technical indicator however still has cash and fixed income showing greater relative strength than stocks, commodities, and foreign currencies. This broader relative strength indicator by itself is suggesting that portfolio emphasis still be placed on cash and fixed income. In short our technical indicators are presently sending out mixed signals. What about our fundamental economic picture?

In adherence with our investment management mantra ***Do no harm, and Make Money\**** (please read sidebar), we do our best to corroborate technical (supply and demand including relative strength) research with fundamental research (economic and business fundamentals). Fundamental research in our estimation is not yet glowing in favor of a strong up trend in either the economy or the stock market. (*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%
2009	+18.9%

### 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%
2009	+30.5%

YTD thru 06/30/2010

S&P500 -7.56%

NASDAQ -7.04%

10/11/2007 HI thru 06/30/10

S&P500 -33.7%

Mar 2000 HI thru 06/30/10

NASDAQ -58.2%

\*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.

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Audit Integrity, Inc., a private company that monitors accounting and governance practices of U.S. companies on July 23<sup>rd</sup> published a report related to economic fundamentals. U. S. Corporate Accounts Receivable, that is money owed to a company for goods or services provided to their customers, has risen from \$36 trillion to \$41 trillion from Q1 2009 to Q1 2010. That is a 14% increase in Accounts Receivable. Average Days Payable has increased from 93 days to 136 days. That increase in days payable calls into question the quality of the Accounts Receivable held as Assets on the books of many U. S. corporations. In short the debt and debt servicing problem is a continuing dilemma and also may be a telltale sign that all is not right with corporate financial strength. Also corporate treatment of Accounts Receivable is one of the leading areas of accounting fraud and given the year- to-year deterioration, the Accounts Receivable situation is not a healthy economic sign.

Weekly Leading Indicators published by Economic Cycle Research Institute (ECRI) have also been signaling weakness in the economy.

Basically, relating our market indicators back to mountain climbing it's similar to one of those times that there is a mix of blue sky and gray sky and an uncertain forecast. Being prepared for changing weather conditions is good sense in planning for a hike in the mountains. It is also good sense to be prepared for a changing investment climate when structuring and adjusting investment portfolios. Having dry clothing in reserve when hiking is like having some dry powder (money on the sidelines) when investing. Both will help protect you against conditions over which you have no control. This is especially important when conditions are in a very uncertain state as they are right now.

We believe that our strategy of focusing on stocks with strong financials and strong governance and that have a history of growing dividends is sound. We believe that the market right now remains overvalued but may be speculated up more in price in spite of a backdrop of fundamental weakness. In this scenario whatever gains might be made over weeks or perhaps months could be very quickly erased by fundamental setbacks. We believe as always that patience is a virtue. As opportunities arise we will participate if we feel the price is attractive for good returns over time.

Jobs remain a key to growing us out of the wide-spread debt problems. Government policies in terms of Financial Reform, Fiscal and Monetary policy, Health Reform, Energy Reform, and so on will have a great impact on the future. All of these areas remain hotly controversial and unsettled. As they settle out, and if they are sound, we would expect more private jobs to come on line and with that, better days ahead. For the near term we remain cautiously optimistic. Using our mountain climbing theme, we continue to be hiking our way through ups-and-downs and switchbacks with a chance of more bad weather ahead and the summit not yet in sight.