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Investment Insights

May 2009

MIRRORS, MIRRORS ALL AROUND

Once upon a time, on a Christmas day, I was one of a half dozen aircraft commanders temporarily deployed to Flagstaff, AZ. That area of the country had been immobilized by a severe blizzard. Our mission was to deliver food and medicine and, in some cases, do medical evacuations. We arrived after the storm on a clear, cold bright blue day. My helo was loaded up with Department of Agriculture, forty pound burlap bags full of canned goods and dry food staples. We were flying over a place adjacent to the Grand Canyon known as the little grand canyon. Each of us was assigned a sector and were briefed that if a mirror flashed at us, to fly over and drop a bag of food. It sounded simple enough.

We took off from our improvised staging area and headed out toward our mission sector. We flew above a great expanse of high desert, canyons, and mountains. The landscape below us was breathtakingly beautiful in its brand new Christmas suit of pure white snow. We were at once a witness to, and a subject in one of Nature's most wondrous works of art. It was truly God's country.

We expected that there would only be a handful of people living there. Well, we quickly discovered that there were quite a few hundred Navajo Indians somehow making a life in this rugged terrain. Not only that, but every darn one of them seemed to have a personal mirror hanging around their neck.

We were all of a sudden beset with mirror flashes, **mirrors, mirrors all around**, flickering and shining in our eyes as we flew. We were overloaded in an instant and I shook my head at my original thought that this would be a simple mission. Wrong! Given the impossibility of one single bird responding to all of those mirror signals, my decision was to essentially set up and fly an expanding box pattern. I would drop food to those mirror-flashers who were closest to our flight path. We had absolutely no way to tell whether the person behind one mirror might be in a whole lot more need than the person behind another. We just did the best we could and I

know we helped at least some of those stranded souls in the middle of God's country.

In the business of investing, there's a parallel to the **mirrors, mirrors all around** dilemma. There are thousands upon thousands of public investments that are available to us, all around the world. There are certainly more than we have time to look at, let alone analyze in depth. Obviously we can't, nor do we want to, invest in all of them. So how do we do it?

First, we do it much more effectively, than delivering food to the Navajos based on mirror signals. We do it with the help of leading edge information management technology – computers and data base systems. It's kind of like reducing a torrent of water coming out of a fire hose to a manageable stream of water coming out of a garden hose. We reduce an information overload of thousands of competing investments to a manageable size. In that process we also sort the information by criteria that we choose, based on the value of a range of information relevant to making decisions. An example is if we're looking at stocks, part of the information that we want, is the companies that are in a favorable sector and that have a good to excellent accounting and governance rating. Many filters can be used to give us what we want to review.

How we divide money across asset classes, given market conditions, determines more than 90% of the performance in a portfolio. Our decision on how much to weight each asset class in a portfolio is one of the most if not the most, important investment decision for any given market condition.

What is an asset class? There are four categories. One asset class is **cash or cash equivalents** such as a money market or a foreign currency. Another is **fixed income**. Fixed income includes CD's, Treasuries, municipal bonds, corporate bonds, convertibles, and all of their equivalents in the international market place. *(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 04/30/09

S&P500	-3.37%
NASDAQ	+9.75%

10/11/2007 HI thru 04/30/09

S&P500	-43.85%
NASDAQ	-38.05%

*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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The asset class that we most often talk about is **stocks or equities**, domestic and international. The final, is a catch-all asset class called **alternative investments**. The latter includes an array of investments such as real estate, commodities (energy, grains, sugar, livestock, precious metals, basic materials and so on), collectibles, and a variety of hedge funds.

Once we determine percentage weightings for each asset class, we then choose specific investments within each asset class. They can be in the form of mutual funds, exchange traded funds, individual stocks or bonds, a specific currency, a specific commodity, and so forth.

Packaged products such as variable annuities, 401k's, and variable life insurance, typically have a limited number of investments wrapped inside them. For those, we set up portfolios of the investments within each, and then use our information management tools to help us manage them. We believe that our methodology and our leading edge tools help to place us among the best in the industry in preserving and growing our clients' assets.

Let's take a look at our current market conditions. The S&P 500 has moved from its March 6, 2009 intraday low of 667 up to an intraday high of 889 as of April 30th. That's a 33% move up from the lows.* In addition, the S&P500 has moved up above its 150 day moving average which is good news. The 200 day moving average is at 963 so there would be a ways to go before the S&P 500 starts bumping up against that ceiling of resistance.

The volatility or fear factor index (VIX) remains in a downtrend although still at a high level. The fact that it remains in a downtrend is a good sign. This stock market rally has been very strong and very rapid. Where we go from here is, as always, anyone's guess. We are certainly due for a pullback. At this point though our supply-and-demand indicators have us on the offensive, and as always, we have a game plan to adjust if market conditions turn against us.

The fixed income yield curve is positive (long maturity returns are higher than short maturity returns) and that is usually positive news for the stock market. Currently, treasury returns are roughly 6 mos: 0.3%; 2yrs: 0.92%; 5 yrs: 2%; 10 yrs: 3.2%; 30 yrs: 4.1%. On the other hand, a rising interest rate environment will tend to put a drag on fixed income investment performance. Exceptions would be in the areas of the municipal bond market and high yield bond market which appear to have upside potential and also generate great interest returns.

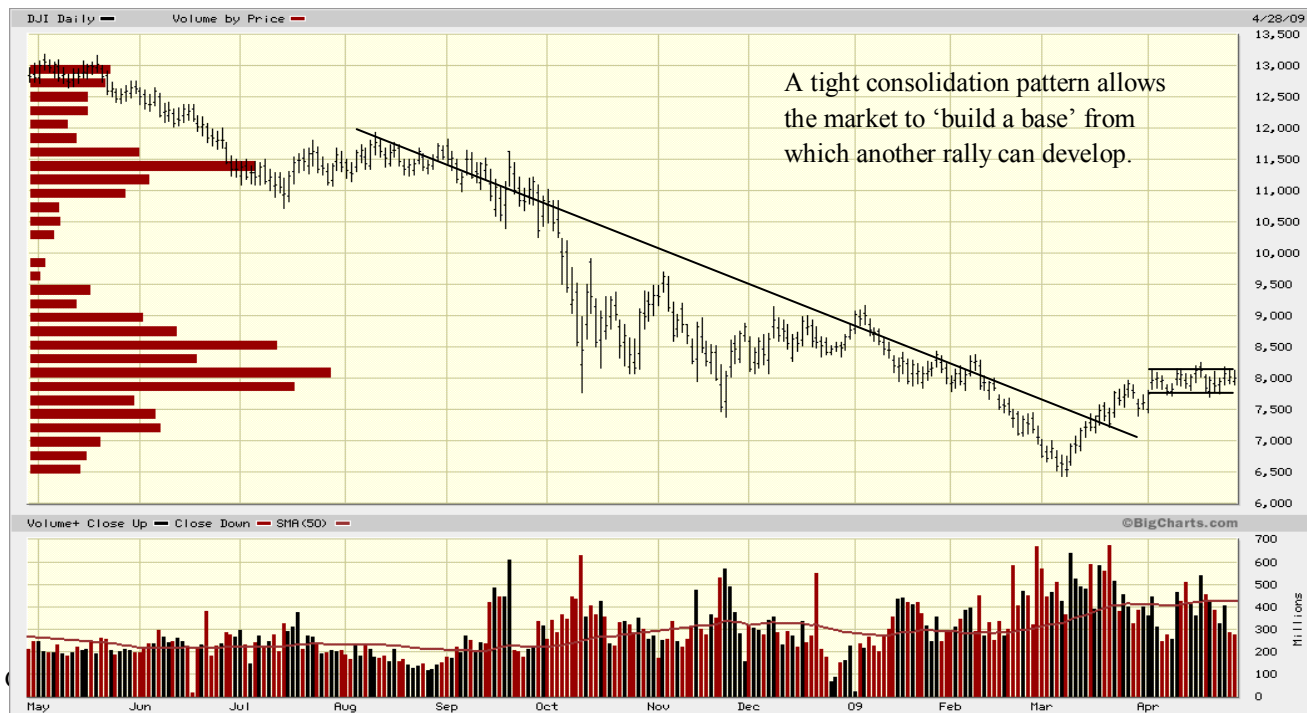
The top two asset classes right now are international equities (especially emerging markets) and commodities. These are showing better strength relative to fixed income or cash equivalents. Looking deeper, we see strength in small and mid-size growth companies, technology, telecommunications, basic materials, consumer cyclicals, and the financial sectors. We continue to monitor, and are in a wait-and-see mode with regard to the U.S. dollar.

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The below chart is a good picture of where the stock market is. While this is the DJIA, it generally mirrors the S&P500. When the market rallies as rapidly as this one has, often times it will either pull back about one-third to two-thirds or it will consolidate for a period of time. What you see at the right end of the below chart is a period of consolidation over the past month. To reiterate, no one knows the future direction of the market. It will do what it will do. That being said, a sideways consolidation such as this could lead to another leg up. As I write this on May 4th, both the S&P and the DJIA have broken up through their 150 day moving averages. Very good news but not a guarantee

I would be very surprised if we do not see some sort of pullback sometime soon. That breathing out would be a healthy thing. Overall though, even with a pullback, right now it looks like there is more room for some upside. We'll see.



In line with our investment management mantra ***“Do no harm and make money”*****, we continually monitor our portfolios and the market conditions and have a game plan in place to adjust as the market conditions change. We work continually, every day to be the best in our industry at protecting and growing our clients’ assets. We are all getting through this rough patch we’ve been handed and our aim is to continue to get our clients through it better than most.

Please contact us if you know of someone who would like to do a better job with their investment assets.

* As of May 4th the S&P 500 has moved up 36% from it’s March 6th intraday low of 667. The S&P 500 is now back up above 900. That, as we mentioned in earlier newsletters and bulletins, is in line with our independent assessment that the S&P 500 fair market value, should be between 900 and 1000.