

# William Baker

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## Investment Insights

November/December 2010

### Galoshes, Mittens, and Wool Caps

Once upon a time we were all kids and during the holiday season we looked forward to the cold and snowy weather. You can all probably remember those first snowstorms that covered the ground and trees with a beautiful coating of white. The snow and ice transformed the outside dark grays and browns into a winter wonderland of Nature's own snow and ice sculptures. That was all good. The other 'really good' was that usually the schools were closed and it was time to get out and play in the snow.

It was a time of snowmen, snow forts, snowball fights, snow angels, and snow ice cream. For some it was also a time of ice skating, sledding, and skiing. It was a time of red cheeks, bright red noses, and hot cocoa. It was a time for sweeping snow, shoveling snow, and spreading rock salt on icy patches. And it was most certainly a time of galoshes, mittens, and wool caps. I remember my mother using safety pins to attach my mittens to the sleeves of my coat so that I wouldn't lose them. Can you imagine a child losing a mitten?

Well the Holiday Season, cold weather, and even in Atlanta, a little bit of snow are upon us. While I no longer have galoshes down here in Atlanta I have already been wearing mittens and one of several wool ski caps from when I used to ski. And they've come in handy in warding off some of this bitter cold weather that's nipping at us. It's always a good idea to be dressed and prepared for the cold, snow, and ice.

We use galoshes, mittens and wool caps to keep warm and protect our bodies against wet feet, frostbite and hypothermia. For our financial protection we also want to have protective measures to deal with market cold snaps.

*Two powerful protective measures regarding our financial security are: 1. insurance to protect against catastrophic losses, and, 2. diversification to avoid large investment losses.*



*Examples of insurance* include medical insurance, life insurance, home and auto insurance, long term care insurance, disability insurance and the like. Let us know if we can help you out with any of these.

*Diversification* is the most fundamental protection against large investment losses. I'd like to briefly discuss a few different aspects of diversification. The general idea is not to have all of your eggs in one basket. So, have investments diversified across and within asset classes. We break them down for our business into six main asset classes: *Cash Equivalents, Fixed Income (e.g. bonds), Foreign Currencies, Domestic Equities, International Equities, and Commodities*. Within each of these broad classes, there may be several, or several thousands of, sub categories. For instance real estate would be a sub-category under equities, gold and silver would be sub-categories under commodities, of which there are more than 100. Also, there are many packaged products such as mutual funds and exchange traded funds that focus on certain asset classes or bundle a variety of classes and sub-categories of securities together. (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 11/30/2010

S&P500	+5.54%
NASDAQ	+9.17%

10/11/2007 HI thru 11/30/10	
S&P500	-24.03%
Mar 2000 HI thru 11/30/10	
NASDAQ	-50.53%

\*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 previous paragraph describes the general understanding that most have with regard to diversification. Other ways are also important. Diversifying across *taxable*, *tax-deferred* (e.g. IRA), and *tax-free* (e.g. municipal bonds or ROTH IRA) is a second means of diversifying. The rationale is that our tax laws change over time and we don't know until it happens how it might affect our investments. For retirement nest egg money it's important to consider diversifying across conventional investment portfolios and investment portfolios with living and/or death benefit guarantees.

Given current demographics, popular guaranteed investments are annuities that provide guaranteed growth and an associated guaranteed lifetime income stream. If married, the guaranteed income stream could also continue through the life of the surviving spouse. That provides great peace of mind to spouses whose only other income might be social security.

Remember that there is no risk free investment, no perfect investment, and that every investment decision is a compromise. It's a matter of matching a person's unique requirements with investment products and strategies that will best meet those requirements. Appropriate diversification though applies to all and underlies all sound investment programs. I would like to make just a few brief comments on the current market conditions and economic backdrop.

The U.S. dollar has rallied some but in general remains in a sea of uncertainty relating to domestic and foreign sovereign debt and the movements of other currencies. I'm reluctant to be other than neutral at this time on the future direction of the dollar. Commodities such as grains and gold and silver are affected by the dollar. However, basic supply and demand also affect their values. The demand for grains appears to be strong worldwide and that demand could have a greater effect on grain prices than the value of the dollar. Gold and silver have been on a tear and are most likely due for a pause or a pullback. Longer term I believe the trend of precious metals will remain up given the amount of paper money being generated by central banks. For the time being though we've taken profits in precious metals and are waiting for a better entry price.

We've been selectively buying dividend generating stocks in many of our portfolios. We look for companies that have strong accounting and governance ratings and also a good track record of growth and also growth in dividends. One of those just declared a 2 for 1 split. Stock investments are a way that we want our clients to capitalize on dividends, splits, and buyouts which over time can be very lucrative. There are never any guarantees but we are emphasizing research and execution in purchasing high quality companies whose Boards of Directors look after their shareholders. We usually, but not always, limit such positions to about 5% of the total portfolio value.

The U.S. treasury ten year yield has been rising and mortgage rates have in turn also been going up. In general we have recently been in a rising interest rate environment across the spectrum from one year notes out to thirty year bonds. A rising interest rate environment coupled with a stock market that is now technically at a high level of risk is a general warning alarm for the equity markets. That means we are poised to become more defensive than we presently are if a market cold snap moves in. While we don't use galoshes, mittens and wool caps we do have other means of protecting our portfolios against cold snaps as they descend on us. We also continue to work every day to improve our skills and tools to adhere to an investment management mantra to ***Do no harm and make money.***\* (please read the sidebar caveat)

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We remain in difficult and very uncertain times with major problems yet to be solved in the housing, banking, and regulatory arenas. The good news is that companies have a lot of cash in their coffers. If business certainty replaces uncertainty, good things should happen. New investment, new industries, and job creation should happen. That would be a great gift in the New Year!

On behalf of all of us at William Baker & Associates, Inc., I'd like to take this opportunity to thank all of you for your good will and support and wish each and every one of you and your families and loved ones a very Happy Holiday Season and a Happy, Healthy, and Prosperous New Year! Your continued support and referrals are one mark of the success of our business. Please contact us if you know of anyone who might be interested in our help in financial planning and wealth management.

Please take a moment during this Holiday Season to give thanks and remember those who are serving and who have served our country to maintain for us the freedom and liberties that we all enjoy. Thank you.

