

Client Bulletin

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Defense is on the field and the field position is approaching excellent! Be prepared!

Let's start off with a quick look at the here-and-now investment picture.

Q: Are we on the offense in wealth accumulation mode, or, are we on the defense in wealth preservation mode?

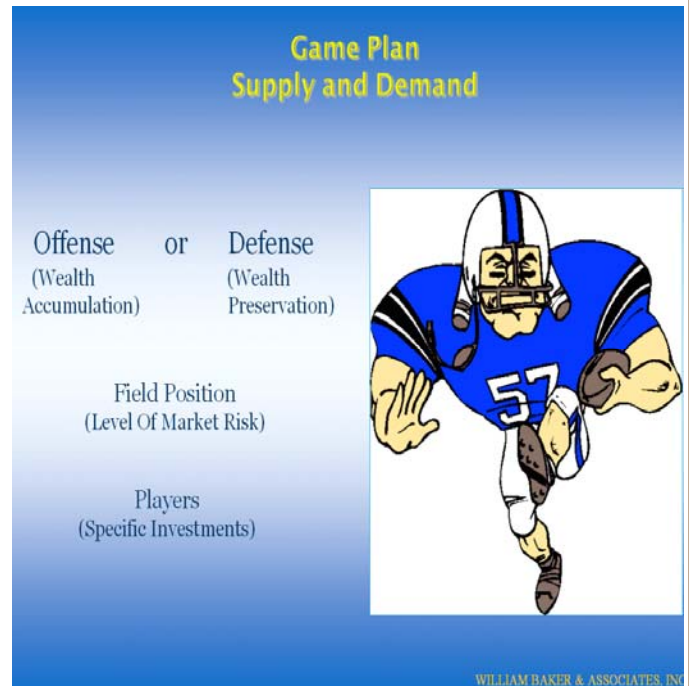
A: We are in a defensive or wealth preservation mode.

Q: What is our field position or the level of market and sector risk?

A: Our investment field position or level of risk has improved substantially with the broad deterioration in the equity markets. That does not mean that markets will not fall further down from here!

Q: What players or securities do we have actively in play?

A: Of the six asset classes that we invest in, our current general weightings in order, are cash or cash equivalents, fixed income (in particular municipal bonds), and dividend-generating domestic equities. (the other three asset classes; currencies, commodities, and international securities are discussed below)



Given the above quick look, let's discuss the situation in more depth to provide you with some more insight.

First, the good news is that I believe we are moving closer to an excellent buying opportunity, and in particular, an excellent buying opportunity in domestic equities.

Fixed income or bond securities have the albatross of low interest rates. Those rates will at some point start rising. When interest rates begin moving back up, bond prices will likely fall. There probably will always be certain opportunity sectors of the bond market but for now their historically low interest rates remain an albatross for bond investing.

International securities, both fixed income and stocks have been weakening and right now do not offer a good investment opportunity relative to domestic investments. Several reasons come to mind: 1. World economies are slowing down, 2. There are major uncertainties regarding sovereign debt crises and concern about contagion and negative ripple effects, 3. There is some probability that the U.S. dollar may, after many years of being in a downtrend, be in the beginnings of a reversal to an uptrend. A reversal up in the dollar trend would be a headwind for international securities.

If the U.S. dollar does reverse trend it would most likely be one of the top world currencies in which to invest. Right now the top two currencies are in fact the U.S. dollar and the Japanese yen. We'll see what happens from here.

In the Lobsters and Lighthouses newsletter last month, I mentioned that gold had been on a parabolic move up, a very risky situation in which to invest. Since then it has dropped substantially and its sister metal, silver, dropped more than 25% in just a couple of days. A strengthening dollar if it continues will act as a headwind for most commodities, and there are about 117 commodities, including gold and silver.

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I'd like to return to my belief that we are moving closer to an excellent buying opportunity in domestic equities. Why not right now? Well now could be the right time, and for some domestic equities it probably is. The S&P 500 dividend yield recently rose higher than the interest of a ten year treasury. In the past that has been a good indicator for a higher market in the months ahead. I remain cautious at this juncture for several reasons. Our own analysis is that a fair value for the S&P 500 is between 1050 and 1100. So far since August, the S&P has bounced off a floor of just above 1100 on three occasions and the question remains will that floor hold? Historically, the S&P price-to-earnings multiple ranges from 7, to the low 20's. Right now the S&P price-to-earnings ratio is about 13. A compression of that price to earnings ratio from 13 to 7 by the investment world, would mean more downside in stock prices and more investment pain. It could also provide that excellent opportunity for investing in domestic equities that I mentioned. We do not have a crystal ball as to whether or when that will happen but history does tend to repeat itself.

Our portfolio values while off some, are generally doing much better than the markets. Also, they have available cash to put to work as opportunities arise, hopefully at a better buy-in point than we have today. It's a continual effort to monitor what the markets are doing, where the best opportunities are, and to plan ahead for both the best and worst case scenarios. Fortunately, we have the incentive and the tools and the experience to do that and to adjust and execute along the way.

These are very challenging times for many people and we are determined to do the best possible job that we can do in navigating our clients safely through these times from an investment standpoint. Again, I'd like to reiterate that we believe that we are in or near an investment trough and that there will be excellent opportunities surfacing as we go forward. It's critical that we be prepared to take advantage of them in line with our investment management mantra **“Do no harm, and Make Money”*** (please read the footnote).

Please feel free to contact us if you have any questions or if you have anyone in mind who could benefit from our services.

*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.