

# William Baker

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## Investment Insights

October 2009

### I Kissed Miss Emma

Once upon a time, I kissed Miss Emma. Peg, my wife, and I were visiting Savannah and were staying at the Mulberry Inn on Savannah's waterfront. That night we went to enjoy dinner and entertainment right across the street from the hotel. Miss Emma, bless her soul, was playing the piano. Emma Kelly, the *Lady of 6,000 Songs*, was one of the many great and very real characters in the best selling true-life murder mystery set in Savannah, GA. The book, *Midnight in the Garden of Good and Evil* was authored by John Berendt in 1994.

My wife and I had both read *Midnight* shortly before our visit to Savannah. Neither of us though had any idea that Miss Emma was still performing let alone right there, that night, entertaining us. We were thrilled. At one of Miss Emma's breaks, I excused myself from my wife's company and went to the piano. No way was I going to miss this opportunity! I leaned over and gave Miss Emma a kiss on her cheek. At the same time, I smiled and said "Miss Emma, this is a kiss from Atlanta. Would you please play *Peg o' my Heart*." She smiled back at me and she thanked me for the kiss from Atlanta. Our eyes parted and I turned and went back to rejoin Peg at our table.



Savannah, Georgia

Upon resumption of her program, as Miss Emma began to play *Peg o' my Heart*, she leaned over into her mike, and she said in her very low and slow southern voice "I've been playin this since 1926". Since 1926! It was a poignant moment, one that we remember. Miss Emma has since passed on, but our brief moment together, her smile, and her kindness in playing my request, remain etched in my heart. I also think it touched my wife in a heartfelt way. It was one of those emotional moments that helps to give our lives meaning and fulfillment.

Acts of kindness, love, and service to others I believe are

in the end what life is all about. While our happiest experiences are moments of positive emotion, our worst experiences are usually associated with destructive emotions that can wreak havoc with our relationships, our health, and our lives. Avoiding and/or managing destructive emotions we would probably agree, could avoid a lot of grief in the world. Easier said than done, and it has so much to do with creating and having realistic expectations.

While positive emotions certainly contribute to the degree of our health and happiness, having money, also helps. Like it or not, money affects day-to-day quality of life. Too little money creates problems. Too much money creates its own set of problems. A common denominator, no matter how much or how little money one has, is that each person has their own unique emotional makeup when it comes to their money and their investments.

Financial psychology is right now one of the fastest growing disciplines in the investment industry. It is the hot topic. It's all about our emotions, our expectations, and the results thereof, on our money, on our investments, and on our lives. In the business of wealth management and investing, decisions based on our emotions, can wreak havoc with nest eggs.

At the extremes, we have the very frightened and risk-averse investors. They are most likely to sell out at a bottom in the market, lock in large losses, and cause themselves a great deal of financial damage. At the other extreme, we have the super-confident, I can beat the market, mindset. They will go for the gold without giving a moment's thought to the downside risk. They too can cause themselves a great deal of financial damage. A DALBAR study over the period 1989 through 2008, shows that the individual investor (in part because of emotionally-based investment decisions), had annualized returns of only 1.87% while during the same period, S&P 500 returns were 8.35%. (*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 09/30/09

S&P500	+14.55%
NASDAQ	+25.7%
10/11/2007 HI thru 09/30/09	
S&P500	-31.98%
Mar 2000 HI thru 09/30/09	
NASDAQ	-57.97%

\*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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*We believe that it is critical to have a reward-and risk-managed investment methodology that removes the emotion from the business of investing. We also believe investment performance is best measured over an entire market cycle.*

We use, and we continually work to improve, a time-tested, reward- and risk-managed methodology. It works very well over market cycles. (trough-to-trough or peak-to-peak) It also is a methodology that removes emotion from investment decisions.

Does it work all of the time? The fact is that no proven investment strategy works all of the time.

Over short time horizons, the market is very noisy and unpredictable. That is why a reasonable approach to evaluating a strategy is over a market cycle. Does that mean that we do not continually measure our portfolio performance against market benchmarks such as the S&P 500. We do, but we also keep our priority and focus on reward vis-a-vis risk. We work to manage both sides of the reward and risk coin for longer-term outperformance. Investor emotions typically track market ups and downs which is why mixing emotions with investment decisions usually ends up with poor results over the longer term. One of the fundamental problems in the industry is that risk management of market and sector risk is typically not being done. Since that represents about 80% of equity portfolio risk we manage that risk with diligence.

What is our current research and analysis telling us with regard to investment conditions?

Our supply-and-demand indicators still show a strong upward bias in stocks and place international and domestic equities at the top rung in the market. Nevertheless, our supply-and-demand research also shows that equity markets are at a high level of risk.

Fundamental economics while improving on many fronts still carries with it the specter of continued increases in unemployment, a crippled consumer, uncertainty as a new wave of mortgage rates reset, a still infirm banking system, rising budget deficits, and a *down-trending dollar*. Many seem to be comparing the current market situation to past market action following recessions. *The fact not-mentioned is that past recoveries were accompanied and sparked by an expansion of credit.* Given the tightness of credit this time around, we believe that *this not-mentioned oversight could be a critical and a foreboding omission.*

Sometimes the market picture can be very clear to us in terms of reward versus risk. Right now the signals are mixed. That suggests that the prudent course is to have some exposure to stocks and some money in other areas. That is our current assessment of, and approach to, our present investment environment. It is in line with our investment management mantra "***First, do no harm, and make money***".\* (please read the sidebar)

I hope you enjoyed the story about *Miss Emma*. Remember that our positive emotions can be very healthy and fulfilling to our lives. On the other hand, our negative emotions can be very damaging to us and to those around us. With regard to our finances and investments, those decisions are best made on a sound basis, and in the absence of emotion.

Our team works continually, every day, to be the best in our field in terms of investment performance and in all other aspects of wealth management advice. We have a disciplined approach to investing and risk management. That approach keeps a continual eye on reward vis-a-vis risk, and has a target on the upside and an exit point on the downside for every security in which we invest. The approach also keeps emotion out of the investment process.

