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Investment Insights

October 2008

BREATHING IN AND BREATHING OUT

Once upon a time, we all took our first breath. Do you remember that? My guess is that you don't! But since then, most of you have probably been breathing every minute of every day. Amazing as it is, normal breathing in and breathing out is just a natural part of our wonderful lives!

On the other hand, you may have experienced, or, know of someone, who got the wind knocked out of them. Breathing is temporarily halted. It normally results from a severe blow to the stomach and solar plexus. That condition is associated with pain and can take a few minutes from which to recover. In fact, if the blow is severe enough, a person may not recover – their breathing days could be over.

You may be wondering where I'm going with this one. Well, there are some parallels that I would like to draw between the breathing process, which everyone of us can relate to, and to the business of investing.

One way to think about how the market, a market sector, or an individual security functions is to think about it as breathing. When breathing in, that's the period during which prices are going up. When breathing out, that's the period during which prices are going down. Just as breathing in and breathing out is normal for each one of us, it is also a normal process for markets, sectors, and individual securities. Prices and values go up and prices and values go down. We see it in our investment statements every month.

Right now we're in a Bear Market! For those investors who are experiencing the brunt of the Bear Market, that's akin to being punched in the stomach and having the wind knocked out of you. For our investors who have had the Bear Market risk mitigated since it started last year, it is more like a normal exhale.

I was telling my associate, Latoya Parker, about the metaphorical theme for this month's newsletter. She immediately exclaimed, "Have you ever had the wind knocked out of you? I HAVE! It was awful! I thought I

was gonna die!" It happened in her childhood when a girlfriend decided to begin spinning like a top with her arms outstretched. Well, Latoya's stomach and solar plexus were smack dab in the line-of-fire of her friend's fast-swinging hand. Latoya crumpled, she gagged, she was struggling to breathe but could not, and she thought she was gonna die! After a minute or so her solar plexus relaxed and she was OK, breathing normal again. That's kind of how investors might feel when their investment portfolio gets hit by the brunt of a Bear Market!

Generally, downturns of about ten per cent, occur every two years or so in the stock market. It is part of normal breathing in and breathing out. A Bear Market is a downturn of 20% or more. That is more serious and is more like getting the wind knocked out of you, or worse. Let's talk more about this.

As most of you know, our investment management mantra is "**Do no harm and make money**".* (please read the sidebar) To make money requires assuming risk. To not do serious longer-term harm requires understanding and managing risk. To do that we continually monitor, assess, and adjust portfolios looking at reward versus risk. That continual due diligence and execution is the primary reason that our actively managed portfolios did so well last year, and continue to do much better than the index averages this year.

As I write this at the end of September, many backbone-of-America, good, decent, regular people have had the wind knocked out of them investment-wise. First was the financial and credit crisis, a culmination of years of poor stewardship and lack of regulation. Then was the failed attempt by public spokespersons to present a clear understanding of the crisis and the steps needed to begin to fix it. Their inadequate presentations made little sense to the public. To add to the problem, CEO's were walking away from the messes they created, pocketing tens of millions of dollars. Infuriating, you bet! (*cont'd*)

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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%

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%

YTD thru 9/30/08

S&P500	-20.6%
NASDAQ	-21.5%

10/11/2007 HI thru 9/30/08

S&P500	-26.1%
Mar 2000 HI thru 9/30/08	
NASDAQ	-58.8%

*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, that is technical research. At times we will use conservative hedging techniques to limit downside risk.

(continued)

Finally, the not-well-supported rescue legislation failed to pass after the Congressional leaders assured the public that it would pass (even though the public did not want it). With failure to begin fixing the problem, the stock market took a severe blow to the solar plexus. It fell gasping, losing \$1.2 trillion dollars in value in a single session. Washington D.C. risk hit hard and hammered the capital markets. This astonishing market reaction made it very clear that something needed to be done. As I write this, the stock market has bounced back a little, however the credit markets remain gasping for breath.

Needless to say September events have confused and frightened many investors. And some investors have been seriously hurt since October 2007. In turbulent markets emotion naturally runs high. Investors often feel and behave like deer in the headlights not knowing which way to go. Our job as professionals is to maintain calm, stick to our successful disciplined approach, and keep assets on track to grow using a risk-managed approach. Every once in awhile the market may get the wind knocked out of it. By using a disciplined, risk-managed approach, our portfolios have avoided getting the wind knocked out. They have exhaled but in a very normal and recoverable manner.

Let's look at the performance of some diversified mutual funds to better understand the extent of what's happened year-to-date (YTD) and over the past year.

	YTD -9/30/08	Rolling Year (9/30/07-9/30/08)
All Equity Funds	-20.6%	-23.7%
U.S.	-18.7%	-21.1%
Non U.S.	-29.9%	-31.7%
Asset Allocation Funds (typically a fund of funds)		
Global	-16.1%	-21.4%
U.S.	-15.8%	-17.6%
Balanced Funds (typically 60% equities and 40% fixed income)		
Global	-18.1%	-21.4%
U.S.	-14.1%	-15.8%

I am happy to say that we are doing a much better job than what you see above. Our internal goal is to consistently be in the top twenty percentile (or better) in terms of performance, service, and advice to our clients. We figure we're in the top five percentile last year and this year. We continually work hard to be the best and at the same time realize that we can be quickly humbled by the capital markets.

September was a horrible stock market month. The S&P 500 fell to a minus 20.6% year-to-date level. At one point it got close to a minus 30% level from last October's highs. For the month the S&P lost about 9%.

At this time money markets, intermediate treasury bonds, inverse funds, and small capitalization stocks are sweet spots in the capital markets. U.S. stocks are showing strength over foreign stocks. Also, the U.S. dollar recently broke above it's long term downtrend line and is suggesting that the page has turned for the dollar. If the dollar continues stronger that will tend to add downward pressure to those commodities that are dollar-based. Remember supply-and-demand is the overriding force affecting oil, gold, and other commodities. A strengthening dollar however, will lend downward pressure on the latter securities. As a final note, after years of avoidance, we're again beginning to look at bank stocks!

As always, we appreciate your interest and continued support and referrals. Your referrals are an important indicator of our business success and excellence!