



Fourth Quarter Investment Commentary January 2009

The Quarter in Review

We probably cannot tell you anymore than what you have already read, heard, or seen about the fourth quarter, and you may not want to hear more about that period anyway. One of the best things you can say about 2008 from a financial standpoint is that it is over. Here are just a couple of items to ponder.

- The S&P 500 fell 38.5% in 2008, trailing only the 38.6% drop in 1937 and the record 47.1% plunge in 1931. Overseas markets fared even worse, with the MSCI World Index falling by 42% in 2008. Last year was the third most volatile since 1929, with 131 days in which the S&P 500 was either up or down more than 1%. The historical median is 47 days per year. In addition, two of the best six days and two of the worst six days since 1929 (in terms of percentage change) occurred in 2008.
- You may have heard of a “black swan event,” which is a nearly one-of-a-kind rare and devastating occurrence. The term was initially used by [Nassim Taleb](#) in his book *The Black Swan: The Impact of the Highly Improbable*. Recently Nigel Marriott, the founder of Bath, England-based Marriott Statistical Consulting Ltd., said of our current financial situation, “It’s way off scale, a one-in-billions chance. This is absolutely a black swan event.” The probability of the events (sub-prime mortgage collapse, Lehman Brothers bankruptcy, the credit freeze, etc.) all coming together as they did this last fall were as likely as winning the lottery twice in a week or the earth being destroyed by an asteroid, said [David Watts](#), a strategist at CreditSights Inc. in London.

Tax Alerts

Typically, you would receive your 1099 forms for tax purposes by about January 31st. Recent federal legislation has extended this deadline until February 15th. The intent of this change is to help to reduce the need to file corrected 1099 forms, which is often a problem for taxpayers who like to file early. This means that you will be receiving all of your 1099 forms from your bank and Schwab later than in previous years. Call us if you have questions.

The U.S. House of Representatives approved bipartisan legislation on December 10th that would temporarily (for 2009 only) suspend a tax penalty for seniors who do not take a minimum withdrawal from their IRAs or other retirement plans. The Worker, Retiree and Employer Recovery Act (H.R. 7327), suspends for one year an Internal Revenue Service requirement that account holders of 401(k)-style (or IRA) plans must withdraw a minimum amount of money every year after they reach 70½ years old. This suspension would be available to everyone regardless of their retirement account balances. This is an important

planning point for those of you who are not dependent upon your IRA withdrawal, or can afford to skip a year in order to reduce taxes.

Looking Ahead

“This year, about the only way to have averted losses would have been to either sell all investment positions and park the money in cash or take short positions in just about every available asset class. I don’t know of anyone who claims to have had such keen forecasting skills to have done this. Moreover, an adviser who places such big tactical bets will be wrong far more often than he or she is right.” – Blaine Aikin, Fiduciary360 LP

“There are some really extraordinary opportunities in the credit world. Everything, from bank loans to investment-grade bonds to less-than-investment grade bonds, is priced at really extraordinarily cheap levels.” – David Swensen, Yale University investment chief

As an investor, it’s difficult to think long-term when the markets are so volatile and the media is busy screaming bad news that is designed to hit you in your emotional core. But what is required to be successful at investing is to think beyond today’s headlines, try to remove emotion from the equation, and to maintain your investment discipline. That’s what Wealth Management Advisors is here to do for you.

We held true to our philosophy of holding a well-diversified portfolio as we began 2008. This helped to limit negative impact on portfolios, but certainly did not protect against all losses. When financial institutions burdened with debt needed to unload assets quickly, all asset classes went down at once. The unexpected part of this equation has been losses in the bond market, previously seen as a safe haven. We did not foresee—nor could anyone have foreseen—the extent of the financial and economic turmoil that has resulted from difficulties in the real estate, commodity, credit and derivative markets.

Independent sources that we respect describe current stock market valuations as attractive, although “cheap” may be a stretch. The perverse thing about the stock market is that the lower it goes, the higher future returns may be. Historically, looking at years when markets have performed poorly, near-term future returns can be very good, as can long-term returns. At this stage of the bear market, and if the bear market continues, then the risk of not owning stocks becomes greater than the risk of owning them. While portfolios may become more volatile in the short-term, we will be setting the stage for wealth creation when the market turns higher. There is little doubt in our minds that low stock and bond valuations should inevitably be followed by above average market returns. Earning long-term returns is a continuing process that requires investors to stay in the game. While our job as advisors is to minimize risk at market tops and maximize returns from market bottoms, we can only do so from the obvious perspective of not fully knowing what the future may bring. While cheaper market valuations should give our clients the comfort of knowing that higher than average returns may lie ahead, the returns will not materialize on a predictable schedule. While there is nothing that says the stock market won’t drift even lower from here, we have a high conviction that investors should not be too far out of the stock and bond markets after a market crash.

To capitalize on current low market levels and to position the portfolio(s) to participate in the likely market recovery, we intend to begin re-building portfolios back to target levels. Not all at once, but rather on an incremental basis during the first part of this year. Just as we reduced

some portfolio positions before the market decline (i.e., when they were “high”), so now we intend to begin to increase some positions while the markets are depressed (i.e., buy “low”) to re-establish our target allocations. Holding to this discipline, one which we have maintained for almost two decades, is absolutely key to recovering from the market we experienced in 2008.

Beyond simply re-balancing to target allocations, it will also be important that we be invested in those assets that can be expected to perform best as market conditions improve. This means that there will be some changes in the specific fund/security holdings we’ll want to own in the portfolio. In the near-term, it also means higher exposure to the bond markets.

In that regard, we are noticing some solid investment opportunities in fixed income securities. To maintain the flexibility to pursue these opportunities, we will be increasing your portfolio’s maximum range of fixed-income exposure to twice the recommended target. Please note that if you have a previously signed Investment Policy Statement, this will be a change in your fixed-income target range. If this change is not acceptable to you, please call us by January 31st, 2009. Otherwise, we will move forward as described to take full advantage of fixed-income opportunities as they arise.

It is certainly possible that the economic news in 2009 will get worse. The stimuli promised by the Federal government will have an effect, but not an immediate one. However, it is also important to separate the economy from the financial markets. The amount of money stashed in money-market mutual funds had surpassed that in stock mutual funds as of the end of November, according to the Investment Company Institute, a national association of investment companies. In contrast, money-market funds were just 48% of the amount in stock funds when 2008 began. When, not if, that money finds its way back into the stock market, it will have a tremendously positive impact on stock prices. Today, Americans are setting aside 42% of their portfolio to cash and cash equivalents, the highest ever. "Never before have these investors allocated as much or more to cash as they have to stocks," says Jason Goepfert of sentimentrader.com. Individuals aren't alone, and even professional money managers are hiding in short-term Treasuries that yield next to nothing. A time will come when earning zero interest starts to get old and investors will begin to take some risk again. That is when you can expect to see markets rise and we want to be positioned to capitalize on this move.

Closing Comments

We anticipate that 2009 will be challenging from many perspectives. What you can expect from Wealth Management Advisors in 2009 is professional competence in applying best practices in investment management, utmost good faith in disclosing material information, avoidance of conflicts of interests and a commitment to placing our clients’ interests first.

In a few years, it will be interesting to sit down and read a few books about what triggered the Great Credit Crisis of 2008. Ultimately, it was a combination of things: a society willing to live beyond its means (a recent editorial in the *Wall Street Journal* blamed the housing crisis on HGTV!), companies taking extraordinary and misunderstood risks, lack of regulatory oversight and just plain old greed and fear. Closer to home, however, is how 2008 affected the relationship between investor and advisor. It was difficult enough to weather the financial storm of a lifetime, but then we had the Bernie Madoff scandal thrown in for good measure. The Madoff scandal, while huge in its proportions, was by no means unique in the financial

industry. One of our clients in North Carolina called us recently about how an “advisor” in her community had fleeced local investors. We understand that our firm’s reputation is earned one day and one client at a time, and we work hard to maintain that reputation.

Thank you for your courage, patience and trust during these difficult times. We take nothing for granted, and are honored by your decision to retain Wealth Management Advisors as your trusted financial counsel. We want to close with a very insightful observation from Richard Foster, author and a former director at McKinsey, the business consulting firm.

“The essence of capitalism is capitalizing—bringing forward the future value of cash to the present so that society can grow more quickly by taking risks. It goes back to the Dutchmen in the 16th century, sitting at their coffeehouses in Amsterdam and Leiden, loaning each other money for a guaranteed return. Someone said, “I’ll give you a little higher return if you give me a piece of the action”—and equity was invented. That had the effect of bringing forward, into real cash today, the net present value of future earnings. That levered society and allowed it to grow at a much higher rate than it would otherwise have. Equity was a very clever invention, and we are not going to give it up. This is the way people are. **This is the way commerce works and will continue to work unless capitalism ends. And that won’t happen, regardless of what you read in the press.**”

Many of you have not been in recently to see us or our new offices. We think it is important to have some face-to-face communication, now more than ever. Please give us a call to schedule some time to meet. Now, let’s get out there and make some money!



Kevin S. McGrew Bruce E. Bower Paul L. Watkins Patrick L. Warren Matthew D. Ison

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