Review for the 1st quarter 2009 and future outlook

'In like a lion, out like a lamb'

Anecdotes and quotations about the weather are as varied as our imagination. One of the most popular sayings is that "March comes in like a lion and goes out like a lamb". Ironically, this saying has great meaning when applied to our financial markets so far this year.

According to the *Farmers' Almanac*, this means that "if a month comes in bad (like a lion), it should go out good and calm (like a lamb). If March starts off cold and stormy, it should end up warm and sunny". It's a little ironic that our financial markets performed in a similar manner.

A financial rollercoaster

2009 started where 2008 left off—with concerns of a prolonged recession, a struggling banking sector and declining housing prices. The financial markets eagerly awaited the arrival of the Obama administration but were disappointed with the lack of details provided by the new treasury secretary Tim Geithner.

Initially, the Dow Jones Industrial Average lost another 25% of its value in 2009, hitting a low point on March 9. However, starting on March 10, the Dow Jones saw a tremendous rally and gained back 16%. Overall, for the 1st quarter, the Dow Jones Industrial Average and the S&P 500 Index finished down 13% and 12% respectively. Like the weather, our financial markets came in like a lion and went out like a lamb.

Sorting though the details

To help sort through all the details and hopefully provide some clarity to questions you may have, we are changing the format that we typically use in our newsletters. What follows are a list of frequently asked questions (or questions we think you want to ask). We cannot cover every topic in the context of this letter, so if you have a question that is not addressed here, please ask us.

March was a good month. Was there finally some good news – or was there simply less bad news?
There was a change of expectations in March. If you are expecting a major snow storm and all you get is rain, then it can feel like a victory. Our financial markets are going through a similar process. Expectations were so low coming into March that markets were able to rally when things were not as bad as expected. It's a case of bad news being good news—similar to getting rain when you initially expected lots of snow and ice.

Are there signs of stabilization?
Yes. There were four unexpected announcements late in the quarter that give us hope the tide is starting to turn:

1. There was some unexpected good news from the banks. Citigroup, JP Morgan and Bank of America all indicated they were profitable in January and February.

2. The U.S. Federal Reserve said it was expanding efforts to pump money into the economy.
3. A government report showing new-home construction rose 22% in February from January's level.
4. U.S. Treasury Secretary Tim Geithner unveiled details of the governments plan to buy toxic assets from banks.

Is the stock market rally for real?
Predicting the stock market is very tricky. Last year we had a few false starts that led to painful sell offs, however, we are now ready to take a shot at calling the bottom. We are cautiously optimistic for the reasons stated in the previous question. In addition, the U.S. Government in coordination with foreign governments has taken other steps to stabilize the world economy. Additionally, the U.S. Federal Reserve has shown a new willingness to use other 'financial weapons' in its arsenal to inject capital into the system and maintain liquidity. Typically the Fed relies only on setting the direction of interest rates.

It seems like the government is supporting the economy. Is this good?
Yes. We believe that government support is vital. Remember that one reason the Great Depression of the 1930's lasted so long was the inability of the U.S. Government to act early. While we do not support nationalization or long term government interventions, we believe that preventing the recession from turning into another depression depends on aggressive actions of the government.

When will the economy recover?
It's tough to say. First and foremost we need stable banks and a sound banking system. We believe that there is a lot of work that needs to be done to achieve this, but progress is being made.

Why is the price of gold so high?
We believe gold is the new 'fear indicator' because it is viewed as a safe haven. Gold has traditionally been a haven for those seeking protection against inflation. However, there is no inflation at this time.

Speaking of inflation, will we ever see inflation again?
Yes. The monetary policies of the U.S. Government are inherently inflationary. The government is injecting a lot of capital (i.e. money and stimulus) into the economy. This will help speed the recovery but we think the side effect will be some inflation.

How can I help protect my portfolio against inflation?
We use an investment called TIPS – Treasury Inflation Protected Securities. TIPS are U.S. Government securities designed by the U.S. Treasury to help protect investors from inflation. We invest in TIPS through mutual funds and exchange traded funds (ETF's) and the allocation, if any, depends on the goals for each client.

Will the U.S. Government initiatives work?
We think it's a good start. We think the plans have a good chance of working but it's likely that more will be needed. It's tough to say what else the government should do until the current stimulus and new programs have a chance to take hold.

What challenges lie ahead for stocks and bonds?

The unemployment rate and consumer confidence are two areas we are watching. If these indicators start to level off or come in better than expected, then that will be a positive for the markets.

What about bonds? Are they safe?
There are many types of bonds and some are safer than others. We see lots of value in higher quality investment grade bonds, municipal bonds and treasury inflation protected bonds. We also see value in higher yielding (lower rated) bonds and preferred stocks – which have some similar characteristics of bonds. We invest using mutual funds and exchange traded funds (ETF's) and the allocation, if any, depends on the goals for each client.

Is now a good time to invest?
Generally speaking the answer is yes. If you have a longer term outlook, there is tremendous value in stocks and bonds. We recommend having a game plan and setting up a dollar cost average program to help take the emotion out of investing. Needless to say, we can help set up a plan or evaluate your existing plan.

We appreciate and recognize the trust you have put in us and your confidence continues to be our highest priority. Please contact us with any questions – or to schedule a review.