

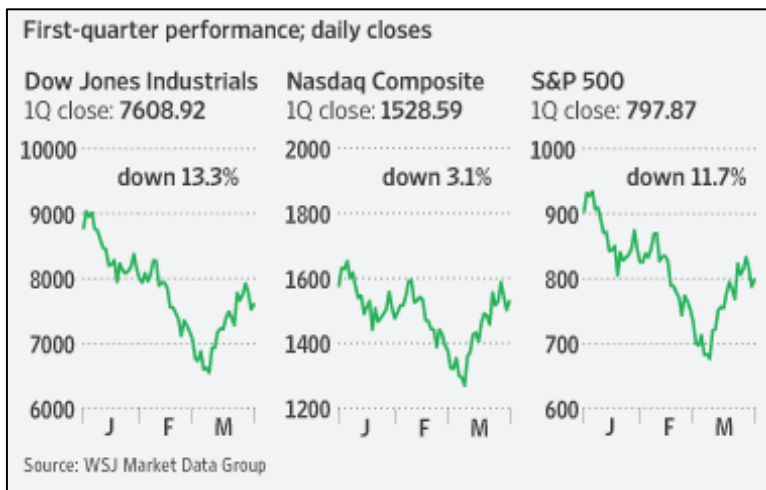
Quarterly Economic Update

1st Quarter 2009

April 20, 2009

Well, another quarter has come and gone and the recession is still not over. While the month of March was the S&P 500's best month since October 2002 (Source: Reuters, April 1st, 2009), there is no assurance that we have seen the bottom of this market yet. Still, I get a big smile on my face when I see the market going in the right direction.

For most investors, the first quarter was a case of one step forward, two steps back. On the one hand, the Federal Reserve, Treasury and various governments worldwide increased their efforts to resolve the current financial crisis, easing fears of a systemic collapse and increasing the willingness of some investors to take on a bit more risk. On the other hand, stocks posted their 6th consecutive losing quarter. Even the 20% 3-week rally in March faded in the final days of the quarter with the announcement of bad news from the auto industry.



The Dow Jones Industrial Average finished the first quarter of 2009 down 13.3%, even though it rose 7.7% in March, including a strut of 22.5% in 19 trading days—the best such increase since 1938, according to research from Biriny Associates in Westport, Connecticut. (Source: Wall Street Journal, April 1st, 2009) The broader Standard and Poor's 500 Index, meanwhile, lost 11.7% in the quarter, despite a jump of 24.5% during that same 3-week rally in March. The tech-heavy NASDAQ Composite Index was a bit more resilient and lost just 3.1% in the quarter. However, the NASDAQ posted its best month in its history during March, with an 11% gain.

As you can see by the charts above, the quarter saw many ups and downs reflecting the changing levels of confidence investors felt in the efforts being made in Washington to resolve this financial crisis. After January, stocks started grinding lower, and on February 10th they began a freefall when Treasury Secretary Timothy Geithner commented that the Administration's plans to rescue the banking system had failed to live up to investor's expectations. This sell-off continued to pick up steam as many investors feared for the fate of some of the country's biggest banks and other global deterioration. By the first week in March the Dow had fallen 13% from its previous low, was down 25% for the year and had declined 54% from its record close on October 9th, 2007. This reflects the worst Bear market since 1929-1932, when the Dow fell 89%. (Source: About.com, DJIA Historical Facts, March 12, 2009)

However, March's short rally, most likely driven by hints of an economic bottom, has technically put the stock market in a Bull market position, by the commonly accepted definition (i.e., a stock market index increase of 20% or more)! Don't get too excited, though—even if we hit bottom and putting that Bear behind us, that does not in any way guarantee a quick recovery.

Companies report their first-quarter earnings in April and there seems to be more than the usual amount of uncertainty about what companies will say. If they fail to meet forecasts or signal a worse-than-expected outlook, it could mean another downturn for the stock market. On the other hand, positive surprises may give investors confidence that market lows may have already occurred in March.

It may seem confusing that the stock market is appreciating at a time when employment is declining, but when you keep in mind that the stock market is not a barometer of the current state of the economy, but a guess about what the economy (and corporate profits) will be 6 to 24 months in the future, the combination of a simultaneous bull market and a recession does not seem so strange.

GLOBAL MARKETS

The Dow Jones World Index, excluding U.S. shares, fell 12% in dollar terms in the quarter, compared with the 13% drop in the Dow Jones Industrial Average. (Source: SAM Indexes, March 2009)

There was a wide divergence in the performance of various markets throughout the world, with results ranging from poor to stellar, but in general shares in developing countries like China and Brazil significantly outpaced those in developed regions like the U.S. and Europe.

Many markets in Europe were sharply higher at the end of the quarter. Australia's S&P/ASX 200 closed the quarter down slightly, while benchmark indexes edged higher in Hong Kong-Shanghai and South Korea. This is a positive sign because it appears that various stock indexes might no longer fall in tandem like they did during last year's universal collapse—perhaps an indication that some of the fear gripping investors worldwide could be decreasing.

There was an Economic Summit Meeting of the world's 20 biggest economic powers on April 2, 2009 and unfortunately, the outlook for the global economy worsened as two international agencies warned that global output will most likely fall in 2009 for the first time since World War II. Fresh evidence of the deepening slowdown came from around the world. It is expected that these countries will set in motion a sweeping overhaul of the global financial system. Although the success of this goal is uncertain, many efforts by various countries, including the United States, have appeared to be helping the various economies around the world stabilize. (Source: Wall Street Journal, "Global Slump Seen Deepening", April 1, 2009)

International stock markets have underperformed U.S. stock markets over the past few years partly thanks to the U.S. dollar. The U.S. is considered the world's financial haven and a common place to park money, and even during this recent crisis global investors have been investing in safer U.S. Treasuries, which finally propped up the dollar after 5 years of weakness. We can look at global and U.S. markets as separate entities, but in today's world everything is interconnected. They invest their money with us, and we are the world's largest importer and account for a significant part of the global economy. With that in mind, some investors feel that the international recovery will get underway once the U.S. economy stops its fall and starts its rebound.

POSITIVE ECONOMIC SIGNS

One of the defining features of this recession is the major role played by confidence – or rather, the lack of it. Fear of the future has caused consumers, businesses, and investors to retreat, to the great detriment of the economy. Many economists predict that this fear will dissipate once signs become visible that the worst of the recession has passed and prospects for a recovery are improving. So here are a few reasons to believe that the bear has rampaged long enough – and that the stock market may be about to embark on a significant, multi-month "snapback" rally:

- March's three-week rally was brought on in part by unexpected good news from the banks, as first Citigroup, and then Bank of America and JP Morgan Chase announced they were profitable during the first two months of the year.

- Home sales rose unexpectedly in February and the National Association of Realtors estimates that up to 45% of existing homes sold were “distressed” properties (those in or close to foreclosure). The stabilization of the housing market is one of a number of critical indicators that might signify that the end of the recession may be in sight. (Source: *National Association of Realtors, “Existing-Home Sales Rise In February”, March 23, 2009*)
- Interest rates have fallen to their lowest in its history. (*Bloomger.com, April 16, 2009*) The demand for Treasury bills is so great that its interest rate is yielding just 0.13% as of April 16, 2009 – essentially nothing. In fact, the interest rate actually fell to a negative yield in December. Think about it – you had to pay the Government money for them to hold your money. The next time someone says to put your money under the mattress – at least you’ll make more money – paying interest is worse than earning no interest!
- Thanks to the Federal Reserve’s aggressive monetary easing, banks are charging each other only 0.5% (annualized) for one month loans – down from 4.6% a year ago. Borrowing costs for businesses and consumers have decreased more slowly, but at least they are headed in the right direction. As interest rates drop, more purchases and projects become affordable on credit. As demand increases, the economy strengthens. (Source: *Federal Reserve*)
- Home-refinancing activity in order to take advantage of lower interest rates (4.87% for a 30 year fixed mortgage rate as of April 10, 2009, the lowest rate since 1971. – Source Department of Labor) should provide consumers more spending money, once the details of the current financial loan approval procedures are finalized.
- Many companies are reducing costs – and equally important – prices. Businesses are improving processes, reconsidering strategies, and looking for growth opportunities as many of their competitors struggle. The survivors will most likely be better positioned and more profitable when the economy finally turns around.
- Inventories for many companies are so low that factory production may have nowhere to go but up, even as demand stays sluggish.
- Many economists and analysts believe that the market is trading at a significant discount and therefore a significant reversal appears to be increasingly probable. (Source: *Profitable Investing April 2009*). The current recession has broken many of the rules of business cycles, but not this one: when something gets cheap enough, buyers emerge.
- Unlike some past recessions or in the Great Depression, when many policymakers did little or nothing, the U.S. and foreign governments have recently implemented large programs to support the financial system and the world economy, and have continued to maintain free-market principles. Government involvement can be a double-edged sword for equity investors, however, as over-regulation can be counterproductive, possibly even diluting a company’s share price.

CASH ON HAND

The uncertainty of the current economy has caused many investors to abandon most types of investments and in turn have placed their portfolios into Treasury bills and other cash equivalent investment vehicles which are now at record levels. Many American consumers are hoarding cash and cutting spending to replenish the \$8.85 trillion plus in collective wealth investors have lost through declines in their stock holdings and their housing. (Source: U.S. News & World Report & Bloomberg, March 2009)

Unfortunately, the economy has gotten worse because even with all of their inducement by the governments around the world to encourage consumers to spend, it appears as though uncertainty and worries have instilled a fear in too many consumers that they are saving more and spending less, which has not helped the economy.

Believe it or not, below is a major headline in the cover story by Newsweek on March 23, 2009. Isn't this ironic? Just think, a short while ago, we were emphasizing people to start saving and now it appears the global goal is to stop saving and start spending.

STOP SAVING NOW

As consumers hibernate and save their earnings, the global economy is withering. This new age of thrift is understandable, but for an economic recovery to actually take hold, consumers around the world will need to start spending instead of saving.

Many of these investors in Treasury bills are holding these investments until they feel comfortable about going back into the market. Once the confidence is restored to these investors, it is very likely that a significant portion of this money earning less than one-half of 1% will be invested back into the stock market, real estate market or other growth oriented investments.

Many companies also have a significant amount of cash available and some have decided to investigate the possibility of purchasing either the shares of other companies or, in some cases, purchasing the entire company itself. The two major reasons: In most cases the price of the company being acquired has significantly decreased over the last 18 months; and second, as mentioned earlier, the interest rates on the liquid investments are so low that many companies feel that it is a better use of their money to start investing it now.

Let's put this into perspective and give an example how these low interest rates can affect your financial position. Keep in mind that this is example is meant for general illustration and/or informational purposes only and is not indicative of any specific investment product. Here are the following assumptions:

- Client is 65 and wants to retire now;
- Client needs \$3,000 per month, gross before taxes;
- Client does not want to touch principal and wants to take out only his earnings from his portfolio to provide his \$3,000 per month;
- Client is very conservative and does not like the significant swings in value of the stock market or other investments;
- Client does not like to see his portfolio change very much and wants liquidity of his investments.

Based upon these assumptions, it appears the only investment that would most likely meet all of his requirements would be Treasury bills. Let us assume for this report that the interest rate on a Treasury bill is 0.1%.

If the client wanted \$3,000 per month, this would be \$36,000 per year. If he earns 0.1%, then he would need to invest \$36,000,000 in T-bills in order to generate \$3,000 per month!

Another example is the current dividend yield on the S&P 500, which is 2.6%, as of April 17, 2009, compared to the current interest rate of approximately 0.1% in Treasury bills. There are significant differences between these two types of investments such as an investor may not invest directly into an index and stock investments involve greater risk, but if you look at the numbers strictly from a yield perspective, it would take 26 years of earning interest on a T-bill to equal 1 year of dividends on the S&P 500! This is another reason why there is a good possibility that the demand for stocks may increase once investors realize how little they are earning in Treasury bills. Please note that dividends are not guaranteed and the dividend yield quoted here may fluctuate.

TRUST AND CONFIDENCE

One of the biggest concerns hanging over investors right now is the fear of bank insolvency. Policymakers have continued to try to solve the problem by proposing a plan to relieve banks of their toxic mortgage-related assets, (see TALF below) but these new ideas require specific details that will take more time to discern and implement.

Our financial system has deteriorated where nobody trusts anybody. Many of the major banks are either insolvent or headed in that direction. Despite an injection of \$148 billion into the economy, 10 leading banks actually reduced their lending by \$50 billion! (*Source: U.S. News & World Report, March 31, 2009*)

How can trust and confidence be restored in our economy and restored quickly? The psychology of our predicament is essential to reviving America, because risk aversion and pessimism among both borrowers and lenders have soared; these two concerns are significantly linked to each other and one affects the other.

BANKING CONCERNS

Another major, continued concern is the availability of credit. Credit is the main artery to the financial system, without which the economy shuts down. Everything depends on the availability of credit: home mortgages, personal business loans, and securities sold by corporations, banks and states. While the banking system has been recapitalizing and the healing process has started, credit has not been readily available for businesses and consumers.

How long this credit crunch lasts will determine the course of our nation's economic life for decades to come. It appears that it is a chicken-and-egg problem: the banks aren't lending because of the weakening U.S. economy and the economy is weakening because the banks aren't lending.

Many investors have lost faith in the marketplace to get us out of this mess. Public sentiment hates bailing out the banks, but unless there is a significant recapitalization, they will still be unable to provide credit to the economy, thereby paralyzing it. The Federal Reserve has been determined to jump-start lending by financial institutions, one way or another, and seeing improvement in this area has become an obsession with many investors as well. Although cash levels on bank balance sheets have nearly tripled from a year ago, loan growth has declined significantly in March, according to the Federal data. That suggests that banks are still not ready to lend, their customers aren't interested in borrowing, or some combination of the two. (*Source: Wall Street Journal, "Debt Concerns Put Brakes On Lending", April 8, 2009*)

The economy needs an easing of credit by the banks. For its part, the Federal Reserve, faced with the threat of a sustained deflationary environment, has maintained its current 0% interest rate monetary policy. Even so, the majority of banks have been tightening credit standards, and it still hasn't been enough to restore confidence and spark economic activity to the level necessary to bring us out of our predicament. (*Source: Federal Reserve*)

The Treasury and the Federal Reserve began a joint program in March called the Term Asset-Backed Securities Loan Facility (TALF), aimed at unclogging the credit markets by reviving loan securitization, or the packaging and selling of loans in the secondary market. The TALF will purchase up to \$1 trillion in new asset-backed securities, which will include consumer and business loans and commercial and residential mortgages, and is seen as one of the most promising new programs by many analysts, who believe it will make a variety of consumer and business loans more readily available. (*Source: Barron's, March 23, 2009*)

ECONOMIC STIMULUS PACKAGE

One of the major changes that took place during the first quarter was the passage of the American Recovery and Reinvestment Act of 2009, which is a \$787 billion stimulus package and is intended to provide a boost to the U.S. economy in the wake of the economic downturn. \$787 billion is a bigger number than many people can comprehend and will have a significant impact on economic activity. (*Source: New York Times, February 12, 2009*). If you want to try

to put it into perspective, imagine—if you can—spending \$1 million a day for more than 2,156 years. (*Source: BTN Research*)

The Act includes Federal tax cuts, expansion of unemployment benefits and other sources of welfare provisions, and domestic spending on education, health care, and infrastructure, including the energy sector, as well as numerous non-economic recovery-related items. This current government action is much larger than the Economic Stimulus Act of 2008, which consisted of primarily of tax rebate checks.

There has been much debate over the content of this unprecedented stimulus package and its potential for restoring investor confidence. However, this and other actions by the Government are steps in the right direction and they must be given time to work.

MARK-TO-MARKET

We discussed Mark-To-Market accounting rules in the latest Quarterly Economic Report, however, below is a very brief summary:

Mark-To-Market accounting requires companies to value financial assets at the lower of their cost or “fair value” – the price that they could sell it today. Unfortunately, a new accounting rule regarding “fair value” was implemented in November of 2007 that has had significant negative ramifications, especially for financial companies. Some investments are difficult to value and there is often no market to actively buy or sell these type of investments. Therefore, many companies had to take big write-downs on various investments even if these assets were not having any problems.

Many stocks got a handout from the Financial Accounting Standard Board (FASB), which relaxed its Mark-to-Market accounting rules on April 1, 2009, just in time to boost the quarterly results of many financial companies. We will probably see the impact of their new rules soon on the next financial reports of many financial companies for the first quarter ending March 31, 2009.

BUSINESS CYCLES

Business progress is not conducted in an even, orderly fashion. Recessions pave the way for business revivals, revivals develop into booms, booms unfortunately breed crises, and crises very often run out into recessions. Businesses have been proceeding in this manner for generations and there is no reason to believe it will ever do otherwise. This optimism about the future does not minimize the fact that together we have gone through one of the worst periods in market history.

Stock markets tend to move in cycles of boom and bust. Because so much of the momentum is driven by expectations of earnings growth that may or may not be realized, stocks are inheritably volatile. Stock markets can be great predictors of where things are headed, just don't expect them to get things exactly right. More often, they overshoot and overcorrect.

Every market cycle contains elements of risk and opportunity. When stocks are up, an investor risks paying too much for them, making the gains unsustainable. On the other hand, when stocks are down, there is the risk you may not buy before the markets go up again, losing out on a potential increase. We've been through this cycle before. (*Source: Capital World Growth and Income Fund, “Navigating Tough Markets”*)

Each economic, market and financial crisis is different from the previous ones. But in various differences, there is also commonality. For example, each crisis is characterized by its own new set of nonrecurring factors, its own set of insoluble solutions, and its own set of very logical reasons for well-founded pessimism.

RECESSION OR DEPRESSION?

Based upon all of these economic problems, many people have expressed a concern whether or not our economy today is in a “Recession” or a “Depression”. We discussed this in depth in the 4th Quarter Economic Report, but I would like to provide a very brief summary here.

By most economists definition, a recession shades into depression when it stretches out for 36 months. Therefore, we have until January 2011 before we cross that line. A replay of the Great Depression (which lasted from 1930 to 1941) looks doubtful, thanks in part to many safeguards now in place that did not exist at the time of the Depression – including deposit insurance, unemployment insurance and a certain willingness on the part of the authorities to print money.

Another major difference is the unemployment rate. In the past year, the unemployment rate has climbed from 4.9% to about 8.5%. (*Source: U.S. Bureau of Labor Statistics dated March 31, 2009*) Although this is a sizable increase over a short period of time, it is certainly not quite the horror of the 1930s, when the unemployment rate jumped to 25% in 1933 from 8.9% in 1930. (*Source: U.S. Bureau of Labor Statistics dated March 31, 2009*)

As you can see, the differences between our economy and that of the Great Depression are significant. Another good sign – I have not seen any soup lines!

INVESTMENT STRATEGIES

Below are a few different investment strategies you may want to implement if they are appropriate for your particular situation. Keep in mind that no investment strategy, can guarantee a profit or protect against loss in periods of declining values.

Modern Portfolio Theory

Modern Portfolio Theory (MPT) is simply putting a certain percent of an investor’s assets into equities and a certain percent into bonds or other investments. Unfortunately, this is fast becoming yesterday’s asset allocation model.

Both academia and the financial industry have general acknowledged MPT as the gold standard for developing portfolios for nearly 20 years. Even analysts say that MPT is still a solid foundation for retiree’s portfolios; however, it needs to be “tweaked”, or changed a little. Therefore, it is not a question about abandoning the MPT all together, but that risks needs to be taken into account which the client did not have previously or never quite understood how much they would need in order to not run out of money during retirement.

This MPT appeared to not work during 2008, when uncorrelated asset classes – except treasury bills – dove into the shallow end of the pool simultaneously, possibly signaling the end of an era.

Buy-and-Hold Strategy

A very common investment strategy that has been used for decades is the Buy-and-Hold strategy. It doesn’t get much simpler. This is investing for the long term, which is a difficult concept to swallow for many investors right now, many of whom have lost faith in the long-term growth of their investments, have decided it’s better to stay out of the market altogether or feel the need to take a much shorter-term approach.

The significant ups and downs of the current stock market have prompted some investors to abandon the Buy-and-Hold strategy in favor of opportunistic trading. Some want more control over their money and some are leaving advisors and managed accounts. And on top of that, some investors have experienced a feeling of helplessness caused by losses in recent months. Some are attempting to recoup their losses, while others are stepping back into the markets after a recent string of stock gains and better-than-expected economic news.

Staying the Course

Most financial advisors still believe investors should stay the course as a whole, but often make slight changes to their portfolio to show they are doing *something* rather than just waiting for the market to recover. Frequent trading can incur fees, erode returns and result in higher income tax bills. However, many individuals have lost faith in the long-term growth of their investments and are trying to make money off the market's volatility.

Why stay invested? Several studies have substantiated the benefit of remaining invested over the long-term. One was published in the Journal of Investing (Fall 2008), and looked at equity markets in 15 nations, including the United States, over several decades. It found that an investor who missed the 10 best days of all those markets ended up with about half the balance of someone who remained invested throughout. In other words, if you missed these 10 days, your returns would be different. What would happen if you decided to get out of the market and go into cash? The cost of throwing in the towel and going into cash in a Bear market can be substantial. For example, history demonstrates swift market recoveries can often make sitting on cash a costly move.

Please see the chart below which shows every decline in the S&P 500 greater than 20% from 1950-2008.

PERIOD	MARKET DECLINE*	1 YEAR AFTER DECLINE	2 YEARS AFTER DECLINE
July 10, 1957 - Oct. 22, 1957	-20.45%	31.02%	43.66%
Dec. 12, 1961 - June 26, 1962	-27.97%	32.66%	55.70%
Feb. 9, 1966 - Oct. 7, 1966	-22.18%	32.87%	41.67%
Nov. 29, 1968 - May 26, 1970	-36.06%	43.73%	59.71%
Jan. 11, 1973 - Oct. 3, 1974	-48.20%	38.01%	67.26%
Nov. 28, 1980 - Aug. 12, 1982	-27.11%	58.33%	61.51%
Aug. 25, 1987 - Dec. 4, 1987	-33.51%	21.39%	56.94%
Mar. 24, 2000 - Oct. 9, 2002	-49.15%	33.73%	44.46%
Average	-33.08%	36.47%	53.86%

The market is down 42.74% from October 9, 2007 to November 30, 2008. There is no way to predict when the current market will hit bottom, and the market trough is generally not able to be recognized until well into a market rebound.

Sources: Bloomberg

Past performance is no guarantee of future results. It is not possible to invest directly in an index.

*Returns reflect the performance of the S&P 500 Index (a registered trademark of the McGraw Hill Companies), an unmanaged basket of 500 stocks that are considered to be widely held and thus believed to be an indicator of overall market performance. This index of common stocks is weighted by market value. Returns for the S&P 500 Index are calculated on a price-only basis without dividends and capital gains distributions, reinvested.

To stay the course, you must also determine your risk tolerance level to judge whether or not your asset mix and individual investments are commensurate with the level of risk that you are willing to take. It may be necessary to reposition certain investments in order to be more in line with your current situation.

Staying invested over the long-term, as nerve-racking as that may be, forces the investor to take advantage of the opportunity to participate in rallies when they occur. Although there is no guarantee of a market rebound, it is very important for investors to stick to their investment strategies over full market cycles.

Keeping a long-term perspective isn't easy to do during a current downturn, but it does reinforce that we will get through it. Already, many governments around the world essentially have said, "We are going to do whatever it takes to get this system running smoothly again." (Source: Wall Street Journal, April 11-12, 2009) Unfortunately, it will take time

for stimulus packages to have an impact. After all, when you oil a bicycle chain, you have gotten to roll it around a few times to spread the oil out and get things running smoothly.

Timing the Market

Timing the market is next to impossible. We've already noted that cash and the safer short-term investments usually have low returns that often can't keep pace with inflation. If you want to achieve your most cherished goals, and you believe you need to get out of the stock market now, then you need to do the virtually impossible and be right twice—you need to choose just the right time to leave the market, and just the right time to get back in. Investors who attempt to time the market usually assume greater risks.

Why is timing so difficult? Because invariably, market peaks and troughs are determined only in hindsight. Peter Lynch wrote something to the effect that more money has been lost by people trying to anticipate and avoid bear markets than the losses in all the bear markets themselves. Studies show that investors continue to make the classic mistake of buying too high (after markets have rallied) and selling too low (after severe declines have already led to panic selling at any cost).

Long-Term Investing

For those of you with 30 or so years until retirement, while there are no guarantees, you could make the reasonable assumption that the market will be higher by that time and that long-term investing is a good strategy for you. However, for those of you who are close to retirement or have already retired, you can often times no longer assume that you have a long-term time horizon for your investments. You need to be more conservative with your investment approach because of your limited time horizon.

While most investors at or near retirement would want to begin investing more conservatively, there are certainly exceptions. For example, if you have a sizable estate and you do not believe that you are going to spend all of your investments before you are gone, you might choose to stay invested long-term for the benefit of your heirs.

Rebalancing Your Portfolio

Every investor should determine what percentage of their total portfolio should be invested in stocks, bonds, cash, etc. This percentage changes over time, especially with regards to the stock and bond market ups and downs over time. "Rebalancing" simply involves trimming your investments that currently have a higher percentage of your total portfolio that they should have and investing more in the other investments that currently have a lower percentage than your ideal investment allocation. By doing this, the investor is selling high and buying low. So, in declining stock markets, it means buying additional stocks and possibly reducing bonds and other investments that have gained as a percentage of your total portfolio. Many investors rebalance their accounts when their allocations drift by more than 5 percentage points away from their targets.

Unfortunately, this rebalancing strategy is often easier said than done because it requires selling some of the "winners" in their portfolio and purchasing more of the "losers". This strategy is very successful in implementing the "Buy low, sell High" rule of thumb. Unfortunately, the psychological impact of implementing this strategy must be considered because many investors become nervous that rebalancing during periods when the market continues to go down will result in larger losses. Rebalancing investments may cause investors to incur transaction costs and, when rebalancing a non-retirement account, taxable events will be created that may increase your tax liability. Some investors will only be comfortable buying more stocks when they see signs of stabilization in the housing market and financial sector, as well more clarity about corporate earnings.

So what type of strategy is best used today? A new uncertainty about the old strategies suggests that investment professionals and their clients may have to be more flexible in their investment planning. Will long-term risk-taking be

rewarded as well as it has been in the past? If not, does that imply a more cautious approach and therefore slower economic growth and lower investment returns? The economic and investment outlook will have to be monitored and analyzed more carefully and portfolio asset mixes will likely have to be changed more frequently than in the past. Because individual situations vary, it is important to coordinate the information provided here with individual professional advice.

REVIEW YOUR CASH FLOW REQUIREMENTS

If the old saying is true and “Happiness is a positive cash flow!”, then it is essential to put together a budget of your regular monthly expenses. It would be a good idea to keep at least 6 months to 2 years worth of living expenses in very safe, liquid investments that you can tap into in the event you lose your job or are faced with another type of cash-flow predicament.

In addition to this, you should also write down a variety of different expenditures you think you will have during the next 12 – 24 months that are not part of your regular monthly expenses, such as purchasing a new car, putting on a new roof, etc. These are the kind of large “surprise” expenditures that can throw a wrench into any budget if you haven’t built them in. Add this estimated amount to your cash flow requirements in order to prevent you from having to sell some of your growth-oriented investments, such as stocks, in the event that the stock market was down and you needed the cash ASAP.

After you prepare your budget, look at each of your “fixed” expenses and determine if any of them can be lowered. For example, property taxes—if your home has declined in value for the last few years and if your property taxes are based upon the value of your house, you might be eligible to petition that your house be reassessed and hopefully your property taxes will go down. And your mortgage—with interest rates dropping so low, it may be best to refinance your house and get a mortgage with a lower interest rate (please check all the costs associated with refinancing before you make any final decisions). Don’t forget that you can comparison shop for many utilities and other services, and that in some cases your current provider may be willing to match a competitor’s lower offer just to keep you as a customer.

Next, look at each of your “flexible” expenses and determine if any can possibly be postponed or reduced. Examples could be travel, gifting, etc. It may be best to reconsider your prior attitude with regards to what is considered “par” vs. extraordinary, such as flying coach vs. first class.

Do not take out more than you need from your various investment pools because that often causes another trap – the more money you have available to spend, the more money you usually will spend!

LESSONS OF THE PAST

This Bear Market has been a painful experience for most investors, but a new experience only for some. Many seasoned investors might remember the 1973-1974 market slide, which was the worst economic downturn since the Great Depression (until now). The Dow has fallen 54% from its October 2007 high compared to the Bear market of 1973-74, the market climbed back from its 45% decline, making those years some of the best for buying stocks. Many advisors believe that this is again the case and that the panics in November and early March might have shaken out the worst of the selling. (Source: *Bettertrades.net*)

Another lesson we’ve learned from studying the markets is that value and price can diverge for long periods of time. In euphoric times, such as during the internet bubble, the stock prices of many companies exceeded their value. In times of panic and dislocation, like today, the value of many companies exceeds their price. In such periods, you should keep in mind that poor reported results *may* indicate deferred returns rather than permanent losses.

Investors are buyers. Buyers are always looking for the lowest prices. In a Bear market, prices are usually driven down by fear and sellers who are taking whatever they can get and not demanding what the investment is worth. Many investors

do not realize the potential opportunity of a bear market; you just need to have patience and keep in mind that while many of the stocks will rebound, future investment returns are not guaranteed. See the Value Trap section below for further discussion. Past performance cannot guarantee future results.

Unfortunately, even if investors can recognize such opportunities with their heads, many times their stomachs have other ideas. As legendary manager Peter Lynch observed, “The key organ (for investment success) is your stomach. Everyone has the brain power, but not everyone has the stomach for it.” In today’s bear market, many investors are racing for the exits. Cash is going into the “risk adverse” securities like short-term U.S. Treasuries with virtually no yield. Although such a choice often feels good, it is, given the near certainty of inflation in the near future, likely to prove very costly. Meanwhile, investments in many high-grade common stocks, which often feel like a terrible place during market declines, may prove to be profitable. There is a good possibility stocks may outperform cash over the next decade. Please remember that equity markets are volatile and an investor may still lose money.

AVOIDING THE “BEAR TRAPS”

In a chaotic Bear market like this one, it is very easy for investors to fall into one or more of the following “traps”:

- Searching for a miracle stock that will pay off big enough to recoup all of their losses.
- Scrambling to make trades based on the latest news reports and not on longer term trends.
- Shaking in fear of losing money to the point that you don’t do anything at all!

Hopefully, a bit of common sense and logic will help you avoid these pitfalls. Here’s a look at some common missteps – and how to avoid them:

1. **The Value Trap** – A stock market like ours makes it easier for many investors to convince themselves that just because a stock is cheap it is now a great value. Although this is true sometimes, other times there is a good reason that the stock is cheap: it’s in trouble! It is important to look past the share price and examine the fundamentals of the company, industry and other factors before you decide that something is a bargain.
2. **The Risk Trap** – Another reason investors are so vulnerable is that there are other forces at work – the urge to recoup losses. Many investors are desperate to make back some of what they have lost and they hope their portfolio will return back to “normal” (or to where at least they were before this Bear market hit). Some investors are more willing to take more risk with their investments and sometimes place significant bets on individual stocks.
3. **The Scapegoat Trap** – Many, many people believe they are above average – at least in investing! Overconfidence makes it very easy to blame others for your losses and many investors who use financial advisors think they would have been better off making the investment decisions themselves. However, that attitude ignores the fact that in this bear market, nearly *everyone* is in the same boat, regardless of who is managing the money. Even Bill Gates, President of Microsoft, watched his Microsoft stock lose 45.4% during 2008. If anyone could have foreseen this current economic climate, wouldn’t he have made changes to the company to prevent the stock from decreasing, or at least gotten out of the stock before it went down?
4. **The Paralysis Trap** – The current market has left many investors too terrified to act at all, whether to sell portfolio holdings to limit losses or take advantage of what may be appealing long-term investment opportunities. Some investors who have decided not to consider stocks for their portfolio could be running a real risk if inflation rears its ugly head. These are often the same investors who would have jumped at the chance to buy more of the stocks they already own at today’s low prices (compared to what they were two years ago), but their minds can’t get past the recent financial trauma and they’re frozen in place. The world has not changed dramatically enough to justify that kind of paralysis. About 91% of Americans are still employed, and we don’t see the S&P 500 going down to zero!

5. **The Comfort Trap** – Not much better than paralysis. A low-risk investment strategy, while it may make you feel safe, as a general rule will produce minimal returns. You will often pay for your feeling of reassurance with significant fees, a sharply limited upside potential and an investment vehicle that often cannot keep pace with inflation. Consider diversifying into equities or other investments.
6. **The Chasing-The-News Trap** – Investors can do tremendous damage to their portfolios by trying to judge exactly the right moment to get into or out of the market. Instead of acting on every change in the financial world, it is usually better to look past this noise and invest small amounts regularly, an approach known as dollar-cost averaging that removes timing from the equation altogether and helps keep emotions at bay. This strategy is more likely to lead to sustainable gains over the longer haul. However, it is not a guarantee you will make money either.

Many investors find themselves in these Bear traps because they have relied on emotions instead of logic. It is important to find ways to start thinking logically again. For example, it helps to do something as simple as making a list of your investment goals and putting it on the refrigerator and reviewing this with your financial advisor. Whenever you are tempted to act impulsively and respond to something you see on television or hear from a friend at a dinner party, you can go back to that list and remind yourself that yanking money out of the market may not be the best strategy.

DO-IT YOURSELF INVESTORS

Some investors have decided to manage their investments by themselves, which is usually not a good idea. The reality is that few investors have the requirements needed to develop asset allocation plans and manage diversified portfolios. In order to do a great job at anything, whether it be investing or fixing your automobile, there are three requirements that are necessary in order for you to do a fabulous job:

1. **Proper education and training.** Many people believe that they will be able to invest their funds without any specific training. This is often a very expensive way to get experience!
2. **Desire.** Those who are truly a success are usually those who love what they are doing. Therefore, it is a wise question to ask yourself, “Would I rather be managing my investments, or – playing golf? – traveling? – visiting my grandchildren?”
3. **Time.** Many investors underestimate the amount of time required to properly manage their investment portfolio, especially if they are investing in individual securities, trading, or other similar activities.

What would you think if someone came to you and told you that although they had no educational background in your field and no job experience, they planned to work part-time doing your full-time job, and they fully expected to achieve better results? If you have not met all of the three conditions above, the likelihood of your investment results being as successful as a professional investment advisors may be called into question.

CONCLUSION

The key to our economic recovery is restoring confidence to businesses and consumers which will be President Obama’s most difficult task. Unfortunately, many are afraid of losing their jobs and their homes. If consumers get a whiff of good news and become confident again, businesses will become confident again. Depending on the strength of their conviction that this economic recovery is real, stock prices could pop up almost immediately.

“How can the stock market recover with all the economic problems we are confronting today?”

Below is a list of a few current important problems:

- Tax increases on America's most productive citizens
- Soaring national debt
- Vastly expanded government controls over health care and energy production
- Higher unemployment and foreclosures
- Plunging retail sales
- The coming Social Security/Medicare crisis

These are just a few of the important issues that we are faced with at this time. Each decade appears to have its own unique problems and even after enduring similar problems over the decades, the Dow still rose from 66 to 11497. The stock market continues to rise in good times and in bad times. *(Source: Warren Buffet, "Buy American. I am." New York Times, October 17, 2008)*

In the words of Abraham Lincoln, "this too shall pass."

Unfortunately, many investors still lost money during a century marked by such extraordinary gains. Many bought stocks only when they felt comfort in doing so, and then proceeded to sell when the headlines made them nervous is a good example of an investor losing money in a bull market.

President Obama offered measured optimism about the economy on Friday, April 10th. With many stocks strengthening and even the housing market showing a few signs of improvement, President Obama said there were "glimmers of hope across the economy." However, he also cautioned that the economy remains under "severe stress" and added that there is still "a lot of work to do". He also said "over the next several weeks you will be seeing additional actions by the Administration. What I just wanted to emphasize today is that we are starting to see progress." *(Source: Wall Street Journal, April 11-12, 2009)*

Keep your fear and uncertainty in check and stay forward-looking when investing. See the opportunities for long-term investors to experience healthy price increases if today's low prices should start to rise (although there is no guarantee that will happen). We look forward to a future when we hope to report that today's low prices become tomorrow's high returns. Thank you for allowing us to help you cope in difficult periods like we are experiencing today.

Sincerely,



Cory T. Schmelzer, CFP[®], CLU[®]
Financial Planner

P.S. After reading one too many stories about investigations of ponzi schemes, many investors might be fearful that their portfolio may have disappeared. This is scary! However, there is a very easy way to be sure this never happens to you. If you hire a financial advisor or anyone else to help make investment decisions for you, be sure he/she is separate from whoever has custody of your money. If your assets are held at a major-name custodian, like Fidelity, Schwab or other similar brokerage companies, have someone else non-connected make decisions what to buy and sell. Make sure that you are getting a separate financial report directly from the brokerage firm. Every story about faked accounts, including those involving Bernard Madoff and Alan Stanford, combined custody of the generation of the investment statements, along with decision making. Once the portfolio manager has custody, he can take the money out the backdoor; separating these functions is a requirement.

Remember – don't worry about things you don't need to worry about!

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Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses. No investment strategy, such as asset allocation, can guarantee a profit or protect against loss in periods of declining values. International investing involves special risks not present with U.S. investments due to factors such as increased volatility, currency fluctuation, and differences in auditing and other financial standards. These risks can be accentuated in emerging markets.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. Rebalancing a non-retirement account may create taxable events that may increase your tax liability.

This optimism about the future does not minimize the fact that we have gone through one of the worst economic periods in market history. Remember that equity markets are volatile and an investor may lose money and there is no guarantee that securities will appreciate.

Sources: Wall Street Journal (10/29/08, 2/11/09, 2/12/09, 2/21/09, 3/9/09, 3/19/09, 3/20/09, 3/23/09, 3/30/09, 4/1/09, 4/3/09, 4/6/09, 4/8/09), Barron's (12/15/08, 3/2/09, 4/6/09, 4/13/09), Investment News (10/20/08, 3/2/09, 3/23/09), Wealth Manager (September 2007, April 2009), Money (November 2008, December 2008, January 2009), Trust & Estates (March 2009), Businessweek (10/6/08, 3/16/09, 3/23/09, 3/30/09, 4/6/09,), Kiplinger's Personal Finance (4/09, 5/09), Journal of Financial Planning (April 2009), Financial Advisor Magazine (April 2009), Forbes (11/17/08, 1/12/09, 3/2/09, 3/13/09, 3/16/09, 3/30/09, 4/13/09), The Economist (1/3/09, 1/31/09, 3/7/09, 3/14/09, 4/4/09), Fortune (3/2/09), Newsweek (10/13/08, 10/20/08, 3/2/09, 3/9/09, 3/23/09), Boomer Market Advisor (March 2009), Morningstar Advisor (February/March 2009), Research Magazine (March 2009), Yahoo Finance (2/24/09), Dow Theory Forecasts (1/5/09), Money Advisor (May 2009), Profitable Investing (April 2009), Dodge & Cox Annual Report (12/31/08), Bob LeClair's Finance & Markets Newsletter (12/20/08, 2/7/09, 4/4/09, 4/11/09), Horsesmouth (4/10/09), Market Analysis, Research & Education (1/2/09), By the Numbers (3/23/09, 3/30/09), Morningstar StockInvestor (March 2009), Selected American Shares (12/08), Sam Indexes (March 2009), New York Times (10/17/08), Reuters (4/1/09) © MDP, Inc.