

Fear or Opportunity?

Thoughts for Worried Investors

January 22, 2008

Housing Collapse and Credit Crunch Are Defining Events of 2007

- Current “storm” always feels worse than any in past memory; appears no end in sight
- Investors increasingly concerned about the overall economy – domestic, foreign developed and developing are slowing
- Credit conditions feel “frozen” and inaccessible
- Stocks have been hammered in short time
- Bonds experienced action too - investors alternated between fear of inflation and recession

2007 Investment Recap

- 4Q was treacherous with much emotional worry
- 2007 (year) was a positive return experience; below historical average; 5th year of Bull Market (started 10/9/2002)
- Domestic large-cap equities outperformed small; growth outperformed value (first time in 6 years)
- High-quality bonds did well; modestly outperforming the S&P 500
- Foreign stocks outperformed domestic for 3rd straight year
- Real estate and finance related investments got clobbered

Asset Class Returns

Periods Ending 12/31/2007

Asset Class	4th Qtr.	12 Months	5 Years Annualized
Domestic Larger-Cap Value	-5.8%	-0.3%	14.4%
Domestic Larger-Cap Growth	-0.8%	11.6%	11.9%
Domestic Larger-Cap Blend	-3.4%	5.4%	12.7%
Domestic Smaller-Cap Value	-7.3%	-9.9%	15.6%
Domestic Smaller-Cap Growth	-2.1%	6.9%	16.3%
Domestic Smaller-Cap Blend	-4.6%	-1.5%	16.1%
Foreign Stocks	-1.2%	15.5%	23.4%
REITs	-12.9%	-16.5%	17.5%
High-Yield Bonds	-1.1%	2.2%	10.6%
Domestic Investment-Grade Bonds	3.1%	6.9%	4.3%
Foreign Investment-Grade Bonds	3.9%	11.5%	7.6%
Commodity Futures	4.7%	16.2%	14.3%
Short-term Local Currency Emerging Markets Bonds	4.4%	16.0%	12.3%

Performance Recap

- Our tactical allocations added value in 2007
 - Increased portfolio diversification; reducing higher risk stock funds
 - Maintained higher large-cap and international stock exposure
 - More aggressive objectives tilted slightly toward growth style funds
 - Maintained focus on high quality bond funds
- Bond managers, growth style and international stock managers all outperformed
- Value managers underperformance was large
- Capital gain and dividend distributions from stock funds was big; causing some funds to see share price drop (after dividend) that justified capturing a loss to offset tax impact
 - Dividends and tax loss harvesting money retained in MMF for future investment when “storm” outlook subsides

Emotional Investing is a Problem

- *Cycle of Market Emotions is highly pessimistic in early 2008*
- *Selling is indiscriminant, as though there is “no tomorrow”; borders on irrational exasperation*
- *Irrational exasperation is sign of capitulation*

In the short term, these factors ultimately provide compelling opportunity for future long term BIG returns

Emotional Investing Causes...

- Investors to shorten their investment time horizon inappropriately: “Long Term is a Green Banana”
- Investment mistakes occur that dramatically reduce long term performance experience
 - Selling locks in low values; losses
 - Future reinvestment decision is late after early BIG rebound happens
 - Resultant long term performance is less than historical Index returns; unappealing

What Are We Doing In Managing Client Portfolios in 2008?

- Cash from year-end dividends and other deposits are currently retained as “dry powder” for future investing; portfolio risk is lower with MMF
- Broad diversification reduces (not eliminate) market drawdown; portfolio values do not decline as much as overall market
- Tactical exposures give emphasis to more undervalued asset areas
- “Buckets of Time” asset allocations provide flexibility to “weather storms”

“Buckets of Time” Asset Allocation

- ✦ Provides *FLEXIBILITY* to weather current storm...
 - ✦ Cash and Bonds are safer haven than stocks
 - ✦ May use cash/bonds for current needs without cashing out of beaten down stocks
- ✦ Provides *TIME* to weather current storm....
 - ✦ Sufficient time allows investor to retain long-term focus for recovery of stock values

In general, “Buckets of Time” assets allow investors to maintain long-term investment objectives.

What Are Others Doing to Help?

- Federal Reserve is responding aggressively - recent 175 basis point Fed Funds reduction
 - Conducting auctions to inject cash into “frozen” credit system
- President and Congress addressing economic stimulus to boost economy
 - Tax rebates and accelerated depreciation
- Foreign central bankers lowering interest rates and injecting cash as well
- Foreign sovereign funds making investments in US and world banks to build capital structure.

What Should Investors be Prepared for in 2008?

- ✦ Review the investment objective established for their portfolio; has anything changed in your personal life that has reduced your investment time horizon?
- ✦ Current market “storms” should NOT be the reason to change a valid long-term investment objective
- ✦ As worry turns to exasperation, talk with us; exasperation is very often near the bottom of the market drawdown
- ✦ Understand that when we see a major sell-off, the silver lining is that it creates great long-term opportunities that provide BIG-size returns

One Last Thought....

- Many successful investors are seeing attractive stock values not seen for many years
- This increases our optimism about the amount of value added that can accrue in portfolios by utilizing historically strong performing managers.
- Try hard to remain a long-term **TIME IN THE MARKET INVESTOR!!!**