

# nVEST nSIGHTS

December 31, 2008

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## FIRE DEPARTMENT CALLED

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

The lead story in the evening news shows the video of a city block a blaze in fire destroying several multi-story buildings. The city fire department and others from surrounding neighborhoods clog the streets attempting to extinguish the blaze. Within hours, the block is destroyed and life is chaotic for those who worked and lived nearby. The fire department was called; it responded; but many wonder if it provided any help.

Investments of all kinds – domestic and international equities of any size, commodities and real estate – fell dramatically in 2008, all dropping more than 32% for the year. International indexes suffered similar bad fate, with the EAFE index declining more than 43%. Almost all bond types, except Treasuries were bruised as well. Even recent faddish alternatives were unable to escape the meltdown.

Calendar-year performance was horrendous for all indexes. The S&P 500 fell 37% and the small stock Russell 2000 index lost 34%. The NASDAQ suffered more, plunging almost 41%. Only 27 stocks (5%) of the S&P 500 posted an increase in value in 2008. Just one stock mutual fund out 1,700 (open more than 3 years with assets above \$50 million) earned a positive return during the year. The market lost ground in each quarter creating single year destruction almost as horrible as 1931 and 1907. In short, it was a lousy year for all investors.

A fire out of control is always the worst, and that characterizes the 4Q of 2008. The S&P 500 lost 22%, and the small-cap Russell 2000 lost 26% during the final 3 months. October witnessed the worst of the meltdown and November 20 appears (at the moment) the bottom for the indexes.

Three- and five-year returns ended 2008 in negative territory. That doesn't mean returns from 2007 and 2006, and etc were negative, but when grouped with the destruction of 2008, the cumulative result is a loss. As you compare returns for 3 or 5 years for the various stock and bond mutual funds (see "Selected Fund Performance", page 4) or portfolio "Benchmarking" returns (page 3), it is sickening to see the red ink of negative returns. One horrible year has wiped out positive returns that took several years to earn. This has been one difficult nine years. During the first 9 years of the 2000 decade, the S&P 500 has dropped over 27%, losing an average of 3.5% per year. That includes the fantastic five bull market years of 2003 to 2007; the losses in 2000 to 2002 and 2008 wipe out the first nine years of returns for this almost completed decade. WOW! NASTY!!

(Fire Department Called - Continued on page 2)

## HAPPY NEW YEAR

Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

How do you define happiness? Where does one find happiness? Amid various definitions of happiness, will one idea of happiness resume with a *positive* portfolio return for 2009? Investors have guarded hope for better days in 2009. After all, it surely can't get worse than the crisis of confidence existing in 2008. It continues to shed a dark cloud on the economy and financial markets as we begin the New Year.

Mark Twain wrote, "History does not repeat itself, but it rhymes." Is that an appropriate thought for 2008? Each bear market has its own unique issues. Still, there are things each has in common.

In a quick glance back, client portfolios (except for the most aggressive all-stock objectives) fared better than the indexes. In a de-leveraging market, all asset classes got clobbered. And liquid securities took a hit as hedge funds and those needing to raise capital sold any asset where markets were easy to trade (it's hard to sell real estate, for example). The most aggressive objective portfolios slid in similar proportions to the indexes. It was a most difficult, disappointing year for all investors.

Client portfolios hold a lot of "cash"; a lot more than usual. During August and September, we rebalanced portfolios, harvested losses to save paying future capital gain taxes, and hoarded the cash in money market funds. "Cash" (aka: money market funds) helped soften the market downfall of the 4<sup>th</sup> quarter. It was a timely move and provided some help during the 4<sup>th</sup> quarter. Cash will also soften or hold back performance during future rally attempts. Our great challenge right now is when to start investing cash.

(Happy New Year - continued on page 2)

# nvest nsights

**“2008 was aberrational in almost every measurable way”**

**“One stock mutual fund of 1,700 earned a positive return during the year.”**

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WEALTH STRATEGIES

**“Attractive opportunities develop in the darkest of hours”**

## **DATES TO REMEMBER:**

- Mid-January - Quarterly Reports
- Early-February - Tax Reports Sent
- March 31 - End of 1st Quarter
- Early April - Mail IRA Contributions for 2008 Tax year
- April 15 - Deadline to file taxes: [IRA Checks must be received by Schwab](#)
- REMINDER: You may request a current copy of our regulatory filing ADV Part II at any time.

## FIRE DEPARTMENT CALLED (Continued)

The fire department has been called. It has responded, and is still responding. The government (Congress, Treasury and Federal Reserve, along with foreign authorities) continue to aggressively respond. Unprecedented policy response is expected to have a stabilizing effect. Unfortunately, its influence historically occurs with a lag of 12 to 15 months. It is hard to answer the question whether the magnitude of response is sufficient and fast enough to curb the downward spiral of asset destruction and potential deflation. We hope so, and expect recovery of asset values over the next several years. Unlike the 1929 to 1932 interval when government response was non-existent (the fire department did not acknowledge the fire), 2008 policy response is huge and fast.

Currently, the market is trying to rebound. Since November 20 (lows), we are experiencing a “holiday” rally. Rallies are typical at market bottoms. They last one to two months, and rally from 15% - 35%; the average is 60 days rising 19%. The current “holiday” rally has advanced 22% and is almost 2 months old. In all likelihood, we expect it will fade away when companies announce dismal, horrible 4Q and 2008 earnings results and job layoffs over the next several weeks. We expect additional rallies (head fakes) in coming months; it is part of the bottoming process. During 2002 – 2003, the tech bear market experienced 6 head fakes, and the seventh went on to become the recent 5 year bull market.

2008 is over; it was aberrational in almost every measurable way. We survived, but not unharmed. We generally lost much less than the market indexes. After a brutal '08, investors must look ahead. We need to approach the markets with respect but also with an eye for value. With almost every asset class selling off, there are some incredible bargains available. Investing with fear instead of care and caution will find us looking back in 5 years at returns we missed. Warren Buffett said, “Be greedy (I say, be selective) when others are fearful.”

## HAPPY NEW YEAR - (Continued)

Client’s psychological risk levels are very low; their time horizons have become very short. Most are discouraged by fear! It seems no one wants to re-acquire risk. The financial markets offer many different asset classes that are historically (even all-time) cheap. Corporate stocks and bonds, and municipal bonds offer values not seen in decades. It’s a great time to plan for the future. Our long-term investment approach has not changed in the last 15 years. We continue to invest with a long-term view that utilizes a very disciplined process. We strive to get the big themes right.

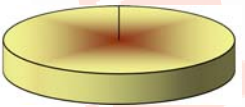
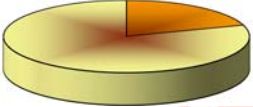
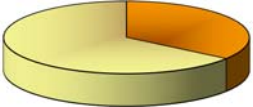
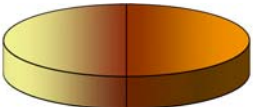

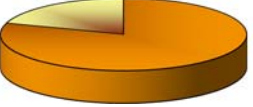
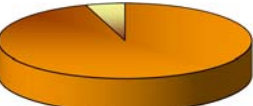
Our focus on quality in all asset classes and among all styles is important to portfolio strategy at bear market bottoms. Further, we have been doing our homework; we already have a tactical asset strategy for the next bull market partially implemented in portfolios. As we invest “cash” in future months our tactical strategy will be fully employed to aid portfolios recover asset value lost during 2008. One key is determining when head fake rallies will evolve into the next bull market. Portfolios will see a few broad tactical ideas being implemented:

- Own a broadly diversified, style neutral portfolio of no-load stock and bond mutual funds managed by active fund managers.
- Utilize active managers, not passive indexes. As volatility normalizes (as confidence slowly returns) cheap assets will do well in active managed portfolios versus indexes (which owning everything).
- Focus on domestic over international (minimal), small- over large-cap, and fairly equal exposure to value and growth styles; corporate bonds over Treasuries.

2008 was horrific. But new beginnings invite us to a look forward; to anticipate a positive outcome for our future. We look forward to defining “happiness” in the investment world with a return to positive performance. Most likely, it may take several years to recoup losses from 2008. And we will via maintaining a careful, watchful and long-term focus. Very attractive opportunities are created in the darkest of hours. Seizing opportunities is how attractive long-term returns and portfolio values accrue. Our immediate challenge is when to invest cash into many cheap asset classes.

# BENCHMARKING AS OF DECEMBER 31, 2008

Summary of index portfolio returns compiled by Nvest Wealth Strategies, Inc.

INDEX PORTFOLIO	STOCK/BOND ALLOCATION	TOTAL RETURN THROUGH 12/31/08				
		4QTR	12 MTHS	3 YEARS	5 YEARS	
 Capital Preservation	0% / 100%	<i>Cumulative</i> <i>Annualized</i>	-1.7% -4.1%	-4.1% -4.1%	3.2% 1.0%	6.6% 1.3%
 Income	20% / 80%	<i>Cumulative</i> <i>Annualized</i>	-6.2% -11.2%	-11.2% -11.2%	-3.7% -1.3%	2.5% 0.5%
 Balanced Conservative	35% / 65%	<i>Cumulative</i> <i>Annualized</i>	-9.5% -16.2%	-16.2% -16.2%	-8.4% -2.9%	0.5% 0.1%
 Balanced	50% / 50%	<i>Cumulative</i> <i>Annualized</i>	-12.9% -22.0%	-22.0% -22.0%	-12.6% -4.4%	-0.5% -0.1%
 Balanced Growth	65% / 35%	<i>Cumulative</i> <i>Annualized</i>	-16.2% -27.5%	-27.5% -27.5%	-16.8% -5.9%	-2.3% -0.5%
 Growth	80% / 20%	<i>Cumulative</i> <i>Annualized</i>	-19.6% -32.8%	-32.8% -32.8%	-20.9% -7.5%	-3.7% -0.8%
 Aggressive Growth	95% / 5%	<i>Cumulative</i> <i>Annualized</i>	-21.8% -36.1%	-36.1% -36.1%	-23.6% -8.6%	-4.8% -1.0%

The index returns reflect returns of various mutual fund averages compiled by Morningstar and allocated as follows: Capital Preservation: 90% Bond Average, 10% Treasury Bill Index; Income: 80% Bond, 10% Large Cap Growth, 10% Mid Cap Value; Balanced Conservative: 65% Bond, 15% Large Cap Growth, 15% Mid Cap Value, 5% Small Cap Value; Balanced: 35% Bond, 20% Large Cap Growth, 15% Mid Cap Value, 8% Small Cap Growth, 7% Small Cap Value, 15% International; Growth: 20% Large Cap Growth, 20% Mid Cap Value, 10% Small Cap Growth, 10% Small Cap Value, 20% International; Aggressive Growth: 10% Bond, 20% Large Cap Growth, 30% Mid Cap Value, 10% Small Cap Growth, 10% Small Cap Value, 20% International. You cannot invest in these indexes or averages. The level of diversification represented by these benchmark averages is materially different than actual client accounts; therefore, clients may experienced different levels of performance volatility. Past performance is no guarantee of future results.

# SELECTED MUTUAL FUNDS - TOTAL RETURN PERFORMANCE SUMMARY

As of December 31, 2008

BOND FUNDS - TAXABLE	STYLE	4TH QTR	12 MTHS	3 YEARS	5 YEARS
<b>BOND FUNDS - TAXABLE</b>					
<i>Taxable Intermediate Bond Average</i>		-0.6%	-4.7%	1.9%	3.1%
Wells Fargo Ultra Short	AS	-4.6%	-6.8%	0.3%	1.2%
Vanguard Short Federal	HS	3.9%	7.0%	6.3%	4.4%
PIMCO Low Duration	HS	1.5%	-1.2%	3.4%	2.8%
Vanguard Short-Term Investment Grade	HS	-2.4%	-4.7%	1.9%	2.0%
American Century GNMA Income	HI	3.7%	7.1%	5.8%	4.7%
Wells Fargo Government Securities	HI	4.5%	7.6%	6.0%	4.7%
PIMCO Real Return	HI	-5.1%	-6.4%	1.6%	3.3%
PIMCO Total Return	HI	5.0%	4.8%	6.0%	5.2%
PIMCO Diversified Income	AI	-6.5%	-13.3%	-1.0%	2.4%
Diamond Hill Strategic Income	AI	-1.1%	-14.8%	-3.7%	-0.3%
Artio Global High Income	LI	-19.0%	-24.2%	-4.2%	0.4%
Victory Convertible Securities	LI	-12.8%	-30.8%	-7.0%	-2.7%
<b>BOND FUNDS - TAX EXEMPT</b>					
<i>Tax-Free Intermediate Bond Average</i>		0.0%	-2.3%	1.4%	1.8%
Vanguard Muni Limited Term	HS	1.5%	2.9%	3.5%	2.6%
T. Rowe Price Tax Free S/I	HS	1.6%	3.0%	3.4%	2.5%
Vanguard Muni Intermediate Term	HI	1.7%	-0.1%	2.6%	2.6%
Vanguard Ohio Long-Term	HL	0.3%	-2.7%	1.7%	2.4%
<b>STOCK FUNDS - DOMESTIC</b>					
<i>S&amp;P 500 Index</i>		-21.9%	-37.0%	-8.4%	-2.2%
<i>Equity Fund Average</i>		-24.4%	-39.1%	-9.9%	-2.2%
Janus Advisor Risk Managed Growth	LG	-25.1%	-42.7%	-12.3%	-4.1%
Marsico 21st Century	LG	-25.8%	-45.2%	-8.1%	0.5%
Vanguard Index 500	LB	-21.9%	-37.0%	-8.4%	-2.3%
TCW Dividend Focus	LV	-26.9%	-43.9%	-12.4%	-4.0%
Diamond Hill Long/Short	LV	-15.6%	-23.7%	-2.7%	5.5%
Munder Mid-Cap Growth	MG	-25.3%	-43.6%	-8.8%	0.9%
Columbia Mid-Cap Value	MV	-27.9%	-41.6%	-9.7%	0.5%
Muhlenkamp	MV	-21.9%	-40.4%	-17.6%	-5.5%
Weitz Value	MV	-24.8%	-40.7%	-13.5%	-6.1%
Century Small-Cap Select (Closed)	SG	-26.7%	-39.5%	-12.2%	-4.7%
William Blair Small-Cap Growth	SG	-29.9%	-46.9%	-16.0%	-5.2%
Neuberger & Berman Genesis (Closed)	SB	-26.6%	-32.9%	-4.3%	3.9%
Diamond Hill Small-Cap	SV	-22.2%	-26.0%	-8.7%	2.2%
James Small-Cap	SV	-20.8%	-35.7%	-12.1%	-1.6%
Wells Fargo Small-Cap Value (Closed)	SV	-24.9%	-38.3%	-8.4%	1.2%
<b>STOCK FUNDS - INTERNATIONAL</b>					
<i>Morgan Stanley EAFE Index (Foreign)</i>		-20.0%	-43.4%	-7.4%	1.7%
American Century International Discovery	MG	-25.8%	-52.2%	-7.8%	3.7%
Harbor International	LV	-21.8%	-42.7%	-2.5%	5.7%
Oakmark International (Closed)	LV	-21.4%	-41.1%	-8.5%	0.8%
Tweedy Brown Global Value	LV	-18.0%	-38.3%	-7.3%	2.0%
William Blair International Growth	LG	-26.6%	-52.3%	-11.5%	0.0%
<b>STOCK FUNDS - SPECIALTY</b>					
PIMCO Commodity Real Return	LB	-35.7%	-43.3%	-12.1%	-0.9%
Vanguard Special Health Care	LG	-9.2%	-18.5%	-1.9%	3.6%
JP Morgan US Real Estate	MV	-39.3%	-39.6%	-12.2%	1.4%
Columbia Technology Z	MG	-28.6%	-51.0%	-13.0%	-1.3%

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