Lassus Wherley ...a view from the top

Building Better Futures

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So Much for Boring!

The Week That Wasn't Boring

There was tons of news this week and none of it was interpreted as positive until late Friday. The Federal Reserve Meeting minutes came out with doom and gloom and the markets tanked. Even with positive earnings reports, we couldn't seem to attract buyers. The real question is why. It can't all be blamed on the hedge funds but it is obvious that they are still selling to raise cash. When you see that huge sell-off at the end of the day, it is typically driven by hedge funds. If you see the markets going down early in the day, that is normally mutual funds. Mutual funds are having to raise cash the next morning if they have redemptions the prior day. I have to say, firms like ours are part of that problem since we are selling some funds to lock in tax losses or to avoid taxable distributions. So……...some of the selling that is taking place is hedge funds having to sell for redemptions and some is tax loss selling for mutual funds. We will probably continue to see activity like this through the end of the year but the volume should eventually lighten up. Also, with tax losses advisors normally buy a comparable fund immediately to stay fully invested. If there isn't a comparable fund, advisors may have to hold the cash for 31 days prior to reinvesting. That means that toward the end of December there could be a lot of buying where this cash is being reinvested.

Finally, on Friday, President-Elect Obama's choice of Secretary of the Treasury came out and the markets took off. The real message was that there is far too little information known about the cabinet and key positions in the new administration. As announcements are made the markets are obviously happy about having the unknowns become known. We look forward to future announcements as the team evolves.

Headlines

I am a big fan of the WSJ and was browsing the headlines yesterday to see what I thought was worthwhile to discuss this week. Here are my favorites and some comments concerning them.

Fed Minutes Paint Gloomy Picture—I found it really interesting that everyone got so upset that the Federal Reserve folks actually think we are in a serious recession. The only thing I could think of is "where have they been"? I actually thought there was some good news in there. The folks at the Fed aren't concerned about inflation and have basically stated they will do what they have to do. I think that is much better news than having them be in denial or sitting in the ivory tower theorizing.

Dip in Power Worries Utilities—Here's a new one. It seems like not that long ago everyone was really worried about not being able to keep pace with the growth in many areas and having serious power outages because of that. Seems like good news when we are paying attention and reducing our usage. Should save some money for all of us.

Gas Prices Spiral Down to Near $2—How amazing is that when just 4 months ago we were looking at prices north of $3.50 and rising. This really equates to a major raise for everyone that does a lot of commuting.

Big Three Head Home Empty-Handed—I am pretty good at arguing both sides of the auto industry bailout. My Mother used to say I would argue with a sign-post if it would argue back (and Clare agrees with her). I do try to make a case on both sides of issues because it helps me decide what I believe is the best answer. This one is really tough. If you take both sides and assume they are overstating the case we still have a major challenge. I end up thinking that we need to restructure the auto industry and probably end up with 1 or maybe 2 much stronger and smarter companies. In the meantime, I think Congress will extend some type of loan to carry them until President-Elect Obama can appoint a Czar to step in, lock these guys in a room and make them fight it out.

Paulson Defends Moves on Crisis—The speech this week sounded like "since you don't want to do what I want you to do, I will just take my ball and go home." Once again our government officials fumbled communication in a massive way. I think one of the more effective tools going forward might be duct tape placed securely over the mouth of certain individuals when they are ready to talk to the media. OK so maybe that won't work. At least someone needs to take these guys through an exercise to make sure they understand that this is not about them, it is about the rest of the world. I am sure you get the idea that I think Paulson really fumbled the ball this week and you are absolutely correct. I'm not sure what he could have done worse.

Consumer Prices Sink Amid Slump—This is bad news????????? I thought this was great news. Of course, everyone flipped from being worried about inflation caused by all the money being pumped in the system to being worried about deflation. What a difference a month makes! The real message here is that we are being affected by reduced demand in many commodities which is causing a decline in prices. However, think about the cycle. Demand drops so there is more supply therefore prices have to fall. When prices fall the supply will be further reduced because the suppliers aren't making as much money. Once the supply falls low enough there won't be enough to meet demand. When demand is higher than supply price will begin to climb. So……...oil prices, etc. will go back up over time as we work our way through this cycle. The only question is when this will begin.

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Bad News—Good News

This is the first time we have faced a real global recession. However, most of the key players around the world are actually working together to provide liquidity needed by the financial systems.

Investors still don't have a lot of confidence in policymakers but hopefully that will change with the change of administration.

The market has largely priced in a rather deep recession. The good news is, if we are able to generate jobs and keep the economy moving, this could shorten the recession and would be a nice positive for the markets.

Oil prices, which until recently were seen as a major threat to global growth, have continued to drop well below their record highs of earlier this year.

There are some interesting ideas floating around to help stimulate the economy. One I heard is to temporarily stop the required payment of Social Security Payroll Taxes. That would certainly add a lot of dollars very quickly. Another idea being discussed is to not require retirees to take out the Minimum Required Distributions for this year. Although this won't be very helpful if they don't do something soon since these distributions must be done by the end of the year and the cut-off date for processing them is fast approaching.

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Here is our latest collection of questions and answers.

Question: *I thought you really liked Hussman Strategic Growth. Why did you sell it?* **Answer:** Hussman is a great long-short fund and continues to be our primary hedge strategies fund. We found out that they were going to distribute a very high taxable dividend. We didn't want to pay taxes on a large distribution so we evaluated all taxable accounts and sold those positions that would have created unacceptable tax consequences. We will hold it for 31 days to make sure the wash sale rules don't kick in and repurchase it.

Question: *Everyone is talking about taking tax losses. Will you be taking losses in my account?* **Answer:** We are reviewing accounts to determine if it makes sense to take tax losses. We will take losses rather than accept large taxable distributions as we did with Hussman. We will also take losses to offset capital gains from profits taken earlier in the year where they exist. We will continue to hold funds where we do not have a specific reason to sell them even if there are unrealized losses.

Question: *I keep reading that we could be in this sideways market for many years. I read something that said this market is like the early 70s and I may not be around long enough to see the recovery.* **Answer:** It is really hard to take history and apply it directly to the future. Each recessionary period is different although there are certainly common factors. We also know that you can take historical statistics and depending on how you slice and dice them you can come up with different conclusions. It is important to understand history to help us avoid the same problems we have experienced in the past. It is also important to try to look into the future, but the only thing we know for sure is that we get very positive returns coming out of a recession. We also know from history that we get very positive returns come out of bear markets. The last thing we know is that we have experienced one of the worse bear markets to occur in our lifetime. Based on those facts, we know that this market will move to positive territory and we expect solid returns "when we see light at the end of the tunnel." The only thing we don't agree on is how long it will take to see the light and what is going to increase the brightness of that light at the end of the tunnel.

Question: *I have read that the period of time where "buy and hold" will work is over. What does that mean and what should we be doing differently?* **Answer:** There is a difference between being a long-term investor and "buy and hold." The buy and hold philosophy is just that. You buy a stock or a mutual fund and you simply hold it. Being a long-term investor doesn't mean "buy and hold." Being a long-term investor means "buy and manage." We focus on the asset allocation first, meaning what asset class makes sense and what should the percentage allocation be in each asset class. Second we look at the subclass. The three subclasses in equity or stock mutual funds are growth, value or what we refer to as core. The allocation between those categories is based on current risk and what we believe is happening in the economy, etc. The third decision point is the specific investment or in most cases the mutual fund or exchange traded fund that we are utilizing for investment. We review all three categories on an ongoing basis. We also rebalance on an ongoing basis which means if you have more in bonds than your allocation calls for we sell some of the bond funds and move the dollars to an investment that has less dollars than the target.

Question: *You seem to like bond funds more than you used to like them. I remember you saying that bonds are really only good for reducing the volatility in a portfolio but aren't very good for long-term investment.* **Answer:** You are absolutely right. I have never been a fan of bonds because of the inherent limitations on returns. However, bonds have definitely outperformed everything else this year and I am becoming rather fond of them. I have also never been a big fan of maintaining a lot of extra cash over an emergency reserve. The violence of this market has also changed my opinion on holding more than needed cash. We have only one objective in our role as advisors and that is to assist our clients in meeting their goals. This severe market has impacted everyone's ability to meet objectives and has required that we review reserves both in cash and in bond funds. So, the bottom line is we have allowed both cash and bond funds to go above the normal allocation where we are concerned about risk, or having adequate dollars to get through several years if needed without having to take dollars out of equity funds.

Question: *You said you were reviewing real estate funds to see if we should be adding money. Have you made a decision on this yet?* **Answer:** Real estate funds have gone down along with everything else this year. We still have these funds on hold and are adding to them very sparingly. We have spoken to the Cohen & Steers folks and they believe that they have eliminated the highest risk REITs from their portfolio and that they will be able to maintain the current yield which is around 6.5%.

Question: *Do you think President-Elect Obama will be able to stabilize these markets and turn the economy around?* **Answer:** President-elect Obama is a very intelligent and thoughtful individual who surrounds himself with very bright, experienced, knowledgeable and thoughtful individuals. His focus is to create jobs to put people to work and kick start the economy through infrastructure projects. I believe this is a really good place to start. He has named very qualified individuals in every post so far and has proven that he can work with both Democrats and Republicans. I think that bodes very well for being able to bring people together to make progress in rebuilding our economy.

The major advantage of the current crisis is that everyone has more of a sense of urgency to actually get something done in Washington. This urgency should not only carry over to the new year, it should pick up steam in getting things done next year. Everyone, well maybe not everyone, recognizes that we have to take action to make sure we maintain a stable financial system, slow the increasing unemployment rate and begin to actually create new jobs. And we need to do this very quickly to shorten the recession and to begin to heal our economy and the economies of the world.

Keep those questions coming in. If you are wondering about something, the odds are pretty good someone else may also be thinking about the same topic. When you ask—we get the chance to share it with others.

I keep hoping for boring and not getting it, but once again I hope things are boring for the next few weeks so that we all have a chance to enjoy our families and think about everything we have to be thankful for during the upcoming holiday season!

Have a wonderful Thanksgiving and please let us know if you have any questions or concerns.

Diahann