Lassus Wherley ...a view from the top

Building Better Futures

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Kicking Off 2009!

Now What?

January has turned out to be a continuation of 2008 instead of the New Year we were looking for. We started off good but fell right back into the up and down and sideways market we have come to know and dislike intensely. President Obama hasn't even had a chance to take a deep breath and neither have we.

The biggest story so far this year has been earnings. Based on a story I read this morning we have had a pretty even split between companies exceeding earnings expectations and those missing their earnings targets. I don't remember seeing any really bad misses but I am sure there were some and we will continue to see more. It has been extremely difficult for companies and analysts to predict the bottom line impact of this economy on earnings but we are keeping an eye on this.

One of the major areas of uncertainty comes from the current debate over the bill in Congress that at last count included over $800 billion dollars. There are many questions surrounding this bill including whether the designated provisions can really create the jobs we need to get the economy moving in the right direction. Some argue that "green" technology infrastructure is too expensive to build and operate and will actually generate fewer jobs for the same dollars. It is a very complex challenge and a new frontier. Not only does no one have the answers today, but most crystal balls really fogged up last year with the roller coaster energy pricing.

The stimulus bill was passed by the House but it remains to be seen what will happen in the Senate. Republican concern at this stage is focused on the seemingly unbridled spending that appears to be characterizing the bill. Wouldn't it be nice if both parties recognized the issues and actually worked together for a change to help this country move forward.

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Here are some of the representative returns for the year as of 1/30/2009:

Category	Return
US Large Cap	- 7.70%
US Small Cap	- 9.70%
Intl Large Cap	-10.78%
Europe	-10.94%
Global Real Estate	-12.99%
Short-Term Bonds	.59%
Inter-Term Bonds	- .05%
High Yield Bonds	4.56%
Emerging Markets	- 8.05%
Muni Nat'l Inter	3.76%
Long Government	- 9.83%

Source: Morningstar Fund Category Returns.

Much Food for Thought

Perhaps the major concern at this point in our economic turbulence is the ability of the banking system to get its act together. Both Citigroup and Bank of America are struggling with the decisions they've made thus far, so there are many new unanswered questions

about what will work and how to rebuild these companies.

Our challenges will continue in 2009 and will include high unemployment, slow economic growth and continuing issues with regulation of the financial industry. The Madoff investigation will produce significant fall-out as the regulators try to figure out how he and his invisible assistants got away with the alleged Ponzi scheme. Finger pointing is increasing between the regulatory agencies and our Congressional leaders. The bottom line is that people are even more worried about financial advisors and don't know what questions to ask anymore.

We also have to worry about a knee-jerk reaction from Congress to fix something that isn't necessarily broken. As Chair of the National Association of Personal Financial Advisors (NAPFA), we have organized a Financial Planning Coalition to establish standards for financial planning. We are very concerned about Congress doing something that will hurt consumers rather than help.

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Here is our latest collection of questions and answers.

Question: *I noticed you sometimes use IRR and sometimes TWR or both. What is the difference and why would you use one rather than the other?* **Answer:** This is always an interesting discussion but the basic difference is that TWR is an average and IRR is a plug. Having said that, here's how we view them. IRR stands for Internal Rate of Return. IRR tells you how fast (or slow) you are making money. The concept is basically: IRR looks at all of your deposits and withdrawals, and the exact timing of each deposit and withdrawal. Then it looks at your current account value. Finally, IRR finds the single annualized rate of return that mathematically matches your current account value to all of your deposits and withdrawals. It's hard to mentally conceptualize, but the important thing to note is that IRR fully takes into account the time value of money. That's why we use it to compare to overall objectives.

TWR stands for Time Weighted Return. TWR is a measure of the compound rate of growth in a portfolio. Because this method is designed to remove the effects of additions and withdrawals of money, it is sometimes used to compare the returns of investment managers. It is assumed that all fund distributions are reinvested in the portfolio and the exact same periods are used for comparisons. When calculating time-weighted rate of return, the effect of varying cash inflows is eliminated by assuming a single investment at the beginning of a period and measuring the growth or loss of market value to the end of that period. TWR weights returns from each period equally no matter how much value is in the portfolio at the time.

IRR is more accurate when you are comparing to a specific goal and is a good measure of the overall growth of a portfolio. TWR is more accurate when comparing the portfolio to the market or when comparing one portfolio to another. We have historically used IRR because it takes into consideration both time and dollars but are moving to presenting both measures since there is no absolute right measure of performance.

Question: *You mentioned a new fund you were evaluating a month or so ago. Have you made a decision yet?* **Answer:** We made the decision the end of last week to go forward. This fund is actually a fund of funds but it only invests in open end mutual funds or Exchange Traded Funds (ETFs). It is actively managed and has held up very well in a crazy market. There are

two factors which slowed down our approval of the fund. The first is that it is a new fund although they have used the same strategies in separately managed accounts for quite some time. The second is that the expenses of the fund are above our normal screens due in large part to the fact that it is a new fund. We will use their institutional funds where the expenses are lower than the retail version of the fund. The name of the fund is EAS Genesis I. We have spent significant time asking many questions and monitoring the actual performance in the current environment. We have added this fund to the recommended list to be used in conjunction with the Hussman Strategic Growth Fund as a hedge strategy fund. We will be moving into it gradually over the next few months.

Question: *Do you think the Obama Administration is on the right track to kick start the economy?* **Answer:** We are hopeful that the new administration is going to take actions that will help us move forward economically and restore the natural optimism we typically project in this country. We believe there is an overwhelming need to create jobs. The question is whether the current plan working its way through the Senate will act quickly enough to do what President Obama and his advisors really want it to do.

Question: *I noticed that my funds aren't reinvesting dividends anymore. Was that an intentional change and if so why?* **Answer:** Yes, the elimination of reinvestment of dividends was intentional. We made this decision based on several factors. The first is to eliminate the risk of triggering the wash-sale rule when we sell mutual fund shares. If a fund is set to automatically reinvest dividends we run the risk of selling within 30 days of a dividend reinvestment. When this happens it triggers the wash-sale rules which mean the loss (if there is a loss incurred) cannot be taken.

The other reason we made the decision is that we want to control how dollars are invested and not allow dividend reinvestment to influence and/or distort how we rebalance accounts.

Question: *I understand that January is one of the best indicators of the performance of the stock market for the year. If that is true it looks like it could be a pretty bad year. Should I be more worried than I am?* **Answer:** The "January Effect" refers to a general increase in stock prices during the month of January. This rally is generally attributed to an increase in buying, which follows the drop in price that typically happens in December when investors, looking to take tax losses to offset capital gains, start selling. It is said to affect small caps more than mid or large caps. This historical trend, however, has been less pronounced in recent years because the markets expect it and have adjusted for it.

The "January Barometer" is a theory stating that the movement of the S&P 500 during the month of January sets the stock market's direction for the year. The "January Barometer" states that if the S&P 500 is up at the end of January compared to the beginning of the month, proponents would expect the stock market to rise during the rest of the year. Any of these "indicators" should be taken with a grain of salt since looking backwards you can read statistics in many different ways.

If you look at the January returns and the market returns since 1940 you get some interesting results. Here are the raw numbers as presented in a article on the website "Seeking Alpha."

Return %

. Year	Jan	Feb-Dec Rtn	Predict?
. 1940	-3.5	-12.2	YES
. 1941	-4.8	-13.7	YES
. 1942	1.4	10.9	YES

.Year	Jan	Return % Feb—Dec Rtn	Predict?
. 1943	7.2	11.5	YES
. 1944	1.5	12.1	YES
. 1945	1.4	28.9	YES
. 1946	7	-17.6	NO
. 1947	2.4	- 2.3	NO
. 1948	-4	3.5	NO
. 1949	0.1	10.1	YES
. 1950	1.7	19.7	YES
. 1951	6.1	9.7	YES
. 1952	1.6	10.1	YES
. 1953	-0.7	- 6	YES
. 1954	5.1	38	YES
. 1955	1.8	24.2	YES
. 1956	-3.6	6.5	NO
. 1957	-4.2	-10.6	YES
. 1958	4.3	32.4	YES
. 1959	0.4	8.1	YES
. 1960	-7.1	4.5	NO
. 1961	6.3	15.8	YES
. 1962	-3.8	- 8.3	YES
. 1963	4.9	13.3	YES
. 1964	2.7	10	YES
. 1965	3.3	5.6	YES
. 1966	0.5	-13.5	NO
. 1967	7.8	11.4	YES
. 1968	-4.4	12.6	NO
. 1969	-0.8	-10.6	YES
. 1970	-7.6	8.4	NO
. 1971	4	6.5	YES
. 1972	1.8	13.6	YES
. 1973	-1.7	-15.9	YES
. 1974	-1	-29	YES
. 1975	12.3	17.2	YES
. 1976	11.8	6.5	YES
. 1977	-5.1	-6.8	YES
. 1978	-6.2	7.7	NO
. 1979	4	8	YES
. 1980	5.8	18.9	YES
. 1981	-4.6	-5.4	YES
. 1982	-1.8	16.8	NO
. 1983	3.3	13.5	YES
. 1984	-0.9	2.3	NO
. 1985	7.4	17.6	YES
. 1986	0	14.3	YES
. 1987	13.2	- 9.9	NO
. 1988	4	8	YES
. 1989	7.1	18.8	YES
. 1990	-6.9	0.3	NO
. 1991	4.2	21.3	YES
. 1992	-2	6.6	NO
. 1993	0.7	6.3	YES
. 1994	3.3	- 4.6	NO
. 1995	2.4	30.9	YES
. 1996	3.3	16.5	YES
. 1997	6.1	23.4	YES
. 1998	1	25.4	YES
. 1999	4.1	14.8	YES
. 2000	-5.1	- 5.32	YES
. 2001	3.46	-15.95	NO
. 2002	-1.56	-22.15	YES
. 2003	-2.74	29.94	NO
. 2004	1.73	7.41	YES
. 2005	-2.53	8.36	NO
. 2006	2.55	10.8	YES
. 2007	1.43	2.12	YES
. 2008	-6.09	-34.48	YES

Analysis: Years 1940 to 2008 = 69 Years
Number of years with Positive Jan & Positive Rest of Year: 38 out of 44 years or 86.4%

Number of years with Positive Jan & Negative Rest of the Year: 6 out of 44 years or 13.6%

Number of years with Negative Jan & Negative Rest of Year: 13 out of 25 years or 52%

Number of years with Negative Jan & Positive Rest of the Year: 12 out of 25 years or 48%

Conclusions: If you have a positive January you have a very high probability of the next eleven months being positive. However, if you have a negative January you have pretty close to a 50/50 chance at a positive next eleven months. So……...although we had a

very ugly January it does not predict a very ugly rest of 2009. One of the more interesting years in this analysis is 2003 which was the turning point in the last bear market. January of 2003 was off almost 3% yet for the year the market was up almost 30%.

Some of the other indicators we hear talked about are the "Super Bowl indicator" which states that if the winner is a team from the old NFL, then the market rises an average of 15% plus. Pittsburgh is this year's victor and we would have actually won on this indicator either way since the Cardinals and the Steelers were both members of the pre-merger NFL, according to John Dobosz reference in *Forbes.* My favorite indicator states that in years where the Pittsburgh Steelers are in the Super Bowl the average return in the markets for the next year is plus 25%. There are many others including the short skirt indicator which states that the shorter the skirts in current fashion the higher the market. Of course, with the bitter cold we are experiencing this year there isn't much chance of seeing this one in positive territory.

The real point is that most of these indicators aren't good predictors of market behavior unless you are looking backward. The most important indicator of the market is really consumer behavior. We need consumers to gain confidence in the economy and only then will we see the other indicators follow that will turn this economy around. I will be covering some of the things that we believe are important leading indicators in our next issue.

Question: *Both my spouse and I have email accounts but you only send the View from the Top to mine. Can we have things emailed to both addresses?* **Answer:** We have recently changed our system so that we can send to more than one email address. Please let us know if you would like us to send to more than one email address and we will make the change in our records.

Question: *You mentioned an investment committee the other day. Who is on the committee and what role does the committee play in investment decisions?* **Answer:** I am the chief investment officer and chair the investment committee. There are five other members who have different levels of experience and different roles. The committee meets every week for at least an hour and the agenda varies. The agenda includes discussion around the economy, the markets and analysis of what is happening. It also includes discussion of all of the areas of investment including asset classes, asset subclasses and individual funds. One of the objectives of the committee is to educate other advisors within the firm who may not have extensive investment experience. The committee is charged with ongoing research on the economy, the markets and current and prospective investments.

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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.

For those who have asked if you can forward our newsletters to others who are worried, please feel free. We put these together as a service to our clients but are very willing to share with others. We also keep them on our website if you would like to refer someone to it at **www.lassuswherley.com**.

Please let us know if you have any questions or concerns. We are definitely looking forward to the recovery in the markets and the economy.

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