Lassus Wherley ...a view from the top

Building Better Futures

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Unbelievable!

What is going on???

So let me see if I can walk through the last 2 weeks. We finally got a congressional bill to "stimulate" the economy to try to get us out of this mess. That was good news. The bad news is there are many things in it that won't necessarily promote the growth of jobs that we need. I won't go through all the good and bad news items since I would be here for a week since it is a very…...long discussion.

Then we had Treasury Secretary Geittner doing a very good impersonation of his predecessor Mr. Paulson. Say a lot without saying anything. Duct tape once again would have been a really good solution to keep the market from tanking the day he spoke. Basically, he talked in very vague terms and really did not give us any assurance that he either has a plan or that details will be forthcoming…….soon. Therein lies the problem. Financial markets and investors hate the unknown. We will continue this up and down and sideways market until we have enough facts to determine if we believe it will work.

Next—I spent last week in Washington and two days of that was on the Hill talking to Congressmen, Regulators, and Senior Staff for the Financial Services Committee. The good news is these are some really bright and dedicated professionals trying to solve the problems in this country. The bad news is they are trying to do it in a very short period of time. That means they will probably get some of it right and some of it wrong. The good news is they are listening. The bad news is that none of us have all the answers.

In the meantime, we have revisited many of the lows of November which we had all hoped we wouldn't have to live through again. Some of the technicians believe if we hit the lows and come back from that we could be starting the next Bull Market. The folks like us who usually are more concerned about the fundamental value of companies aren't predicting very much right now. We still believe that the economy will begin to recover this year but it may take longer than we originally expected. We are pushing our forecast for the start of the economic recovery from late Summer to early Fall and our worse case from late Fall to early 2010. That means we could be facing a market that continues to trade sideways for another few months.

I know it doesn't feel like sideways right now but we moved up from the November lows and have now given back all those gains in the equity markets.

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Here are some of the representative returns for the year as of 2/20/2009:

US Large Cap	- 13.13%
US Small Cap	- 15.82%
Intl Large Cap	- 16.64%
Europe	- 15.53%
Global Real Estate	- 23.55%
Short-Term Bonds	.60%

Inter-Term Bonds	- .33%
High Yield Bonds	3.80%
Emerging Markets	- 11.47%
Muni Nat'l Inter	3.99%
Long Government	- 9.09%

Source: Morningstar Fund Category Returns.

Here are some of our core funds and how they have performed year-to-date.

Harbor Bond	- 1.86%
Vanguard Short Term Corp	2.02%
Vanguard Interm Tax Exempt	3.87%
Vanguard Ltd Term Tax Exempt	1.90%
Hussman Strategic Growth	1.96%
EAS: Genesis I	- 2.54%
Vanguard Div Growth	- 9.93%

Much Food for Thought

We continue to have rumors swirling in the media including one started last week about nationalizing the banks. President Obama and the current administration were a little slow in denying this which led to several days of extremely volatile trading with the banks leading the markets down. They finally came out with a statement that they had no intention of nationalizing the banks and the markets regained many of the losses incurred on Friday prior to the close. Now we understand that the Treasury is reviewing purchasing additional stock of Citi but we will need to see how this rolls out this week.

We will continue to face many challenges in 2009 and the reality is that the economy **will** rebound but probably more slowly than we would like. We also know the markets will rebound but the pain we have felt in this latest downturn will take longer to erase. We will continue to stay more defensive with our allocations until we are convinced that there is a higher level of stability in the financial system and that the markets are functioning with investors and not traders. It means we will hold higher cash, higher bonds and increased hedge strategies funds to balance the risk of the equity markets. We will also continue to edge dollars into various markets as we believe it makes sense.

Here is our latest collection of questions and answers.

Question: *You keep talking about how the markets are becoming more stable. What does that really mean and how will we know when it happens?* **Answer:** Our focus on stability is based on rational trading during the day and at the close of the day. We have seen trading during the day with extreme moves up and down. We have also experienced really fast moves at the end of the market day. A more stable market means a more narrow range during the day and fewer extreme moves late in the day. Late day moves are typically the programmed trades and could still be coming from hedge funds and active traders. They could also be coming from folks who are now getting margin calls based on the lower level of the market.

Question: *You said that President Obama has appointed very bright people who know what they are doing. What if they get it wrong? What's the worst case?* **Answer:** I would expect that they will get some of it right and some of it wrong. There is no science to what we are trying to do in rebuilding the financial system and in trying to kick-start the economy. So……...if they get it wrong the recession will last longer and the markets will probably be more volatile for a longer period of time. The reality is the economy and the markets will recover regardless of what is done. It may take longer depending on the solutions that are offered. I believe the key variable is the "toxic assets" on the books for many of the banks.

Geittner and friends have to get the pricing system and trading systems in place to get these assets back into the mainstream. Until they do, the banks will continue to tread water.

There are other moving parts including the moves to assist homeowners in order to break the log-jam in foreclosures. I'm not a big fan of this program but only time will tell if it will help stabilize the housing market. I believe unemployment is more critical to focus on than the housing market. The housing market will resolve itself over time. Builders will stop building until the glut of houses works through the system as they have in past recessions. During this process market prices will be set based on supply and demand and sanity will prevail. The new valuations will not make most of us happy but we knew the artificially inflated housing prices had to come down at some point. We just weren't prepared for how quickly that would happen. It will continue to cause a lot of pain for people who bought at the peak of the market or who bought to speculate on real estate, but it will also provide opportunities for those who have not been able to afford to buy a house in previous markets.

Employment is the single most important factor for the economic recovery. It drives spending and saving which are both critical for a consumer driven economy. If we really look for a silver lining in the current mess it is the speed at which companies have downsized their workforces in this recession. Companies are usually much slower to react by reducing the number of employees and overall expenses. With the speed of reduction, the assumption is that it will not take many of these companies as long to return to profitability.

Question: *I understand that according to the Dow Theory this market could go down another 15%. Is that true? If it is what can we do to protect against it?* **Answer:** The Dow Theory states that simultaneous moves in industrial and transportation shares forecast economic activity. This is really the type of signal that market technicians follow and use for trading. The recent moves last week have some Dow Theory followers calling for another 15% potential downward move in the market. According to an article in Barron's by Michael Kahn titled *Be Leery of Dow Theory*, "a new low in the Dow is not the scary sell signal some believe. While the market is still sick, it is not terminal." Kahn goes on to talk about why he believes the Dow Theory is outdated. He asks the following questions: "Are the Industrials truly industrial when their ranks are filled with retail, financial and technology stocks? And in the current information age, should not internet infrastructure and telecom companies be represented in the Transports? After all, they deliver products such as the Website you are reading right now."

The case can certainly be made that the Dow Theory needs to be updated. The reality is that the S&P 500 has not yet challenged its November low so even if you are a technician there is hope.

Question: *If this market does go down another 10% what should I do differently?* **Answer:** There aren't specific moves to be made other than what we have been doing. We will continue to maintain higher cash including having dividends moved into the money market. Maintain higher bond funds so that if dollars are needed we can easily access these funds and increase the exposure to hedge strategies funds to complete the defensive position to ride out the remaining period of this bear market. As we see more stability in the markets we will gradually begin once again to rebalance to ease dollars back into equity funds.

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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