Lassus Wherley ...a view from the top

Building Better Futures

Issue 19: April 17, 2009

New Bull Market or a Reprieve from the Bear???

Food for Thought

I did an interview with a writer from a major consumer magazine a couple of weeks ago on the similarities between the grieving process and the experience we have gone through with the market. I am certainly not an expert in this area but there were several things that struck me as we were talking. We have all gone through the denial phase where statements got tossed aside or shredded because if we opened them, we would have to acknowledge how bad this market had gotten.

Then we experienced the anger where we directed our feelings toward Wall Street or Washington or AIG executives or the world or ourselves or anyone else that was headline news that day and being blamed for this mess. Bargaining, depression and acceptance are the defined phases of grieving that follow. Many have experienced feelings of depression over the loss of wealth and a feeling of loss of control over their financial life. It has been an emotional roller coaster ride over the last six months.

And the last phase is one of acceptance. This is where we have had many discussions around taking control of those things we can control and accepting those we can't. The Serenity Prayer that was adopted by Alcoholics Anonymous says it much better than anything else I have run across. **God grant me the serenity to accept the things I cannot change; courage to change the things I can; and wisdom to know the difference.** We are all challenged to recognize those things that we can change and fight to change them. The next phase of this market will, hopefully, not challenge our faith in a recovery on the horizon.

Is the Bad Stuff Over Now?

I am sure we are going to have more shoes drop. The real question is will the good signs beginning to come out be enough to keep people focused on the good vs. the bad. So…….we have seen signs of a slowing in the increase in unemployment. We expect unemployment to continue to go up but hopefully at a slower rate.

The housing market is starting to show glimmers of life. We are seeing small increases in sales of homes but it is still too early to say the market will begin to go up in the near term. Falling mortgage rates are certainly helping those first-time home buyers step up and buy. That is a great sign for the future of the middle market in housing. We still aren't seeing a lot of activity in the higher end market yet but hopefully that will start soon.

We also have earnings season starting again. So far it's been pretty good news with some bad news sprinkled in to the mix. There was an article in the April 6th WSJ written by Mark Gongloff that stated that it is beginning to look a lot like November. What he was referring to is the fact that we had a really strong rally in November followed by the major sell-off that began in January. We do recognize that there is a risk that this market could drop or at least take a really deep breath before we are out of the woods. But we don't believe the risk is as high now as it was in November.

We are beginning to see more shoes drop on the positive than on the negative side of issues. We aren't ready to say that we are out of the woods quite yet but it is certainly looking much better at this stage of the new quarter. Some of the possible other shoes could be related to Defined Pension Benefit Plans and possible underfunding. Companies hire actuaries who estimate the contribution a company must make to its pension in the current year. These estimates are based on the age of beneficiaries, the dollars required at different points in time to pay benefits and the rate of return used. Using a lower rate of return means more dollars would need to be contributed. Add to that calculation the losses suffered in these plans over the last year and that could add up to a lot of dollars for companies and even state and federal government pension plans.

Here are a few more of the good news and bad news bulletins.

The good news items include the following:

Exports rose in February for the first time in seven months.

The market for short-term commercial paper began to come to life recently.

Larry Summers, President Obama's economic advisor, was recently quoted in a WSJ article as saying, "I think we can be reasonably confident that it (the recession) is going to end within the next few months." (April 10th WSJ article written by Sudeep Reddy.)

The consumer price index slid 0.1% in March from February. Year over year, consumer prices fell 0.4% which was the first annual decline since August 1955 according to the WSJ. This could be classified as bad news if you are in the camp that is concerned about deflation vs. inflation but we note that this decline largely reflected the decline in energy prices which is good news for the economy.

The bad news items include the following:

The latest WSJ economic forecast cautioned that it is too soon to say the recession is over.

Retail sales fell 1.1% in March compared to the prior month according to the Commerce Department.

More states are looking at raising taxes. They include the following: Arizona, Connecticut, Delaware, Illinois, Massachusetts, Minnesota, New Jersey, Oregon, Washington, and Wisconsin. California and New York have already passed tax increases which took effect earlier this year. Most experts believe that more states are going to follow the lead of these states and try to make their budgets.

US consumer's savings rate year-to-date is 4.3%. While this is a positive on a personal level, it reduces the likelihood that consumer spending is going to increase significantly enough to help drive the recovery of the economy.

Geopolitical risk is rising. North Korea is being more feisty with a missile launch and reappointment of Kim Jong II as defense chief by the legislature. Ben Netanyahu was returned as Prime Minister of Israel and is unlikely to be patient with Iran. Iran has just inaugurated a uranium fuel plant making their intentions even harder to discern. Pakistan seems unable to control the fundamentalist factions in the tribal areas bordering Afghanistan.

We are still very early in earnings season and the quick run-up in stocks we have seen in the past month has made the market more vulnerable. The market is by definition 27% more expensive than it was when it bottomed on March 9th.

And last but not least, we need to see more active restructuring in both corporate bond debt and in mortgages before we can say this is really over. John Hussman of Hussman Strategic Growth Fund has been very vocal in expressing his concern over the government securing the corporate debt of financial institutions instead of letting poorly managed firms declare bankruptcy and move on. He makes some very good points in his analysis and discussion. If he is correct in his thinking, we could very well see some significant downward movement in the markets before we are totally out of the woods.

Here are some of the representative returns for the 12 months ending 3/31/09.

US Large Cap	- 38.23%
US Small Cap	- 39.05%
Intl Large Cap	- 46.60%
Global Real Estate	- 54.90%
Short-Term Bonds	- 3.07%
Inter-Term Bonds	- 5.03%
High-Yield Bonds	- 21.03%
Muni Nat'l Inter	.93%
Muni Nat'l Short	1.99%
High-Yield Muni	- 17.60%
Long Short	- 14.35%

Source: Morningstar Fund Category Returns.

Here are some of our core funds and how they have performed for the same 12-month period ending 3/31/2009.

Harbor Bond	.90%
Vanguard Short-Term Corp	- 4.0%
Vanguard Interm Tax Exempt	2.9%
Vanguard Ltd Term Tax Exempt	3.4%
Hussman Strategic Growth	-2.7%
Vanguard Div Growth	- 27.4%
Vanguard GNMA Fund	7.0%
JP Morgan Core Bond	4.0%
Stratton Small Cap	- 35.1%
Vanguard High-Yield Corp	- 15.6%
Vanguard High-Yield Muni	- 4.3%

There are still many unknowns in our discussions today and some of them are covered in the questions we answer below. Many will probably not be answered for several months yet.

Question: *I noticed that you sold some of my Harbor Bond Fund and bought another bond fund. Why did you make that switch if you really like Harbor?* **Answer:** We have been looking for an intermediate-term bond fund which we could use to diversify our holdings in the intermediate term taxable bond portion of our portfolios. The primary fund we have been using here has been Harbor Bond Fund. We will still hold Harbor Bond but felt that, in many cases, we had too many dollars invested in this one fund and needed to diversify a bit more. We have decided that we will use JP Morgan Core Bond Fund (Select Shares) in this role.

We chose this fund because it has several attributes which we like to see in any fund. These include a well-defined strategy, management that has been with the fund for some time, a focus on value in their investment choices and good long-term performance.

JP Morgan Core Fund (Select Shares) is managed as a core intermediate-term bond fund with investments spread across mortgage backed securities, corporate bonds and US Treasuries. The portfolio is well diversified and of AAA average credit quality. Fund manager, Douglas Swanson, who has been with the fund since 1991, emphasizes in-depth research into individual issues with a focus on avoiding risk. We like Swanson's conservative approach which has been borne out by an excellent performance record.

You may begin to see purchases of this fund in accounts over the next month or so. For accounts held at Fidelity and NATCO, the fund ticker is WOBDX. For accounts held at Schwab, the fund ticker is WOBSZ.

Question: *Now that the markets have really started to recover some of the lost value, is it time to put everything back into my stock funds?* **Answer:** We aren't yet ready to rebalance to bring all equity up to the long-term target. There is still the possibility that we will see more downward movement in this market. Our current approach is to continue to gradually rebalance and add dollars back to equity over time. Our primary focus is still one of balancing risk and reward in a very volatile market.

Question: *We have had a nice run-up in the market and I am concerned we might give it all back just as quickly. Should we sell some of the stocks now to minimize my losses?* **Answer:** If there is a need for cash, it may very well make sense to take some dollars out at this point. However, if there isn't, it makes more sense to keep the dollars invested for now and ride out the sideways movement we are probably going to see over the next few months.

Question: *Do you think this new plan to get rid of toxic mortgage assets from the banks will work?* **Answer:** I'm not a big fan of some of the things that the administration is doing but this is one where I think action is needed. I think there is a good chance that making a market for these assets will help us work through the problem over time. The real challenge will be getting banks and others to actually sell these assets when they really don't want to book the real loss in value yet. Those who are willing to buy will only buy if they believe they can make money within a reasonable period of time. If we can get this market opened and moving with reasonable prices that create liquidity within the banks, it will go a long way toward getting us out of the current mess with frozen assets on the banks' balance sheets..

Question: *Where will unemployment peak?* **Answer:** We don't expect unemployment to peak for at least 12 months or well after the economy has turned. It will probably hit double digits before it begins to come back down. The more important part of this equation is that we are starting to see more new job creation from the stimulus. Another nice employer this year is the Census Bureau. They are starting to hire for the new Census which will provide at least part-time work for a lot of folks around the country. Every job that is created is going to help us move forward to rebuild the economy.

Question: *When will we be able to stop putting money into the big banks?* **Answer:** That is a very tough question. If it were up to me, it would be done differently. I would have begun purchasing the toxic mortgage-backed securities last year and set up a separate organization to begin the process of marketing these securities. I think that not taking action quickly on this issue is costing us much more than it should. I would also restructure Citigroup and spin off the pieces to bring it down to a manageable level while backstopping depositors with the full faith and credit of the US Government. I believe the current administration needs to be more decisive in this area and less willing to prop up all the banks. There are some truly difficult decisions that need to be made before we will be totally out of the woods.

Question: *When will consumers begin to spend again?* **Answer:** Actually, the numbers from January and February showed a pickup in consumer spending. Unfortunately, the numbers that just came out reflect a reduction in spending. So it doesn't look like we have really turned the corner in this area yet. There is certainly pent-up demand and some of us have no choice but to spend during the summer months. I would expect spending to increase this summer but the real indicator will be whether it can continue to trend up rather than the two steps forward and one step back we seemed to have gotten in the first quarter.

Question: *I keep reading about the car companies going bankrupt and I just read that we are going to let GM go into bankruptcy. Why did we put all that money into the company and then let them go bankrupt now?* **Answer:** I wish I had a good answer for that one. I can only hypothesize that the dollars required to keep them afloat at this point went beyond what the Car Czar and the Obama administration were willing to pay. I am glad the decision was made. Of course I would probably have been happier if the last round hadn't been invested but we are at least moving in the right direction with serious cuts being made in spending.

Question: *The REIT funds seem to continue to perform worse than other funds. Is it time to move on and forgoet them?* **Answer:** There is certainly still risk in the commercial real estate sector and performance has been pretty bad so far this year. We don't expect them to be the first to recover, but we do believe there are good long-term opportunities in this sector and they will help us with hedging inflation down the road. We are starting to nibble on our Global Real Estate Fund while reducing exposure to the pure International Real Estate Fund. We believe that the US market will recover before some of the international markets, so we are using the Global Fund to give us some exposure to both.

Question: *I really like these hedge strategies funds you are using. Why don't we just put all my equity allocation in those funds?* **Answer:** Hussman Strategic Growth and EAS: Genesis I have both performed very well in a crazy market. We don't want to put too much in these funds because they are very actively managed and there is always a chance that they could zig when the market zags. They are great for the purpose that we use them for which is to hedge the risk of the markets and to quickly take advantage of opportunities when they are able to define them. We would not want to put too much in one basket, especially in the current environment.

Question: *Is it time to refinance my mortgage?* **Answer:** It is certainly a great time to refinance if you are able to take advantage of some of the really low rates out there. Rates are at historical lows and costs are pretty competitive.

Much Food for Thought

The challenges in 2009 continue but at least we have some sunshine with which to view them. Six weeks of positive market results does not a bull market make but it certainly has improved my disposition. My crystal ball has been working a little better lately but it still clouds up quite a bit. We are beginning to edge dollars back into the various markets but are doing a tortoise style of slow and steady.

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 our thoughts on the topic with others.

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. Hopefully sooner rather than later. Have a great Spring!

Diahann

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