

**End of Year 2008 Commentary**  
**Congratulations, You Survived?**

Somehow, the words “congratulations, you survived” provide little consolation to what investors endured in 2008. In fact, 2008 finished with the worst performance since 1931. Painful indeed.

In past years, diversification provided a much smoother ride for investors. Unfortunately, this was not the case in 2008 as stocks, bonds, real estate and commodities got hammered not only in the US, but worldwide.

Admittedly, we did not anticipate the decline’s severity or the collateral damage experienced from forced liquidations of heavily margined speculators, hedge fund’s and leveraged financials. While we did not own the headline disasters (Fannie Mae, Freddie Mac, Lehman Brothers, Merrill Lynch, Bear Stearns) we have been impacted as these companies deleveraged.

As panic ensued, selling across the board occurred. In the process, a new bubble has emerged in the US Treasury market as investors arbitrarily sold everything and blindly bought Treasuries. The last asset class we would want to own right now is a US Treasury since bubbles do burst and when it does there will be a stampede out the Treasury door.

We fully anticipate that the economy will be in the ditch for most, if not all, of 2009. Unemployment will continue to deteriorate most likely hitting 8.5%, possibly 10%. It is pretty much a foregone conclusion that the recession will loom through 2009. Fortunately, the stock market on average turns up when we are 60% of the way through a recession. As such, while the economy will struggle we look for the stock market to pick up in 2009.

With oil and gas falling 70% from their peak, greater attention is being paid to the concept of deflation. Despite this, we are far more concerned with long term inflation.

In just the past ten years the indebtedness of the US rose from 5 times Gross Domestic Product to 8 times. There is virtually no way that our debt laden country, that is habitually printing money, can avoid having their currency decline in value relative to other world currencies. An environment of this nature will also face the stiff headwinds of long term inflation.

Given these items alone, there is enough data and news available to make one throw up. **Is there any hope at all?**

**Actually, there are tremendous reasons to be positive.**

1. The earnings yield of the S&P 500 relative to Treasuries has made the stock market the most compelling valuation since the 1930’s.
2. The annual 10 year return for large company stocks has turned negative—something that has occurred only two other times—1938 and 1939. Bounce back after these 10 year periods has been strong for subsequent 10 year periods.
3. The VIX, an index for measuring volatility (and therefore fear), hit an all-time high in November. Remember what Warren Buffett has said: “Be greedy when others are fearful, and fearful when others are greedy.” Now is the time to follow Buffett’s lead and profit from others fear.
4. Significant forced liquidations have occurred from various types of private equity and hedge funds which have caused widespread selling (regardless of value). This produced unwarranted downward pressure on everyone. However, this forced liquidation will not last forever.
5. The amount of cash being held on the sidelines by individuals has now grown substantially larger than the total value of all US stocks. Obviously, once this money moves back into stocks it will be very stimulative.
6. Investor demand for Treasuries has been so great that Treasuries have NO yield! Panicked investors are essentially paying the US Government to hang onto their money for them. This is ridiculous.
7. Institutional investment managers have held high cash balances in spite of acknowledging the undervaluation of stocks.
8. Numerous investment managers with truly spectacular track records (most notably Warren Buffett) have made significant moves into stocks.
9. Insider buying of company stock has been rampant. Insiders are best positioned to know that their companies are not going out of business and this is a once in a lifetime opportunity to invest.

**Finally, we thank you for your support, faith and patience and look forward to a happy, healthy and prosperous 2009.**

Sincerely,