End Of Year 2009 Commentary: 12 Investing Lessons

This year was one of the most volatile in years. By early March the major stock market indices had dropped more than 25% and there was nothing positive on the horizon. However, as quickly as we fell into negative territory we climbed back out by mid-summer. The fourth quarter has continued this positive trend with the markets up more than 20% for the year and up more than 60% from the March lows. Although we are pleased with the rebound, it has surprised all of us.

LESSON 1: Don't Try To Time The Stock Market. Have a well defined investment plan and stick to it.

The year also capped a difficult decade that was mired in a variety of over-extended assets (technology, internet, telecom, housing, credit etc.). In fact, this was the worst decade and the second worst ten year time span in the past 200 years. As bad as that sounds, it is fortunately in the rear view mirror and we are headed forward.

LESSON 2: Do NOT invest in the stock market with less than a 10 year time frame. You must accept the volatility and be patient. Things will go "bump" in the night—expect it and focus on the long term.

This decade's bubbles -- dot-com, housing and credit – can be lumped under one heading, ***leverage***, from which the public and private sectors both are now attempting to recover. The nation's personal savings rate went ***negative*** in 2005, and institutions didn't betray any more prudence, as shown by Wachovia's purchase of mortgagor Golden West Financial just as home prices peaked in 2006. The subprime-credit meltdown began months later, ultimately sinking Bear Stearns and Lehman Brothers, while leaving AIG and Citi in need of bailouts.

LESSON 3: Debt kills. Use leverage very sparingly. This is a lesson that can't be repeated enough.

Burying your money in the backyard or under your mattress may allow you to temporarily feel better, but it only causes more problems. In addition to interest rates on US Dollar denominated assets being at all time low levels; ***the value of the US Dollar relative to other currencies has declined more than 19% this year alone.***

The massive mountains of debt that the US federal government has created this year is only worsening the situation as investors worldwide acknowledge weakness in the dollar. As our drunken government continues to print dollars, this matter will continue to worsen.

Furthermore, in an effort to stimulate the economy the Federal Reserve will keep interest rates low far longer than they should. Short term interest rates will stay low. This will put downward pressure on the dollar and put CD investors in a corner.

LESSON 4: Parking all of your money in CD's or US Treasury bonds <u>will hurt you</u> in the long run.

In 2010, only 16 cents of every dollar of global economic growth will come from the U.S., nearly half the level in 1980. While GDP is tied to the American consumer, S&P profits are boosted just as much by corporate spending and overseas growth. Expansion in overseas markets continues at a much faster pace than domestically. U.S. companies earn a third of their sales abroad, with demand particularly strong in the BRIC economies of Brazil, Russia, India and China, where GDP could grow 9.2% in 2010.

Corporate cash also could provide ballast for the stock market. American corporations slashed capital spending by 16% in 2008 and another 32% this year. As a result, cash now makes up 9.7% of their assets, well above the historical norm near 6.2%. With the ratio of corporate profits to capital expenditure at a record 117%, cash increasingly will be steered toward mergers, capital spending and dividends, all of which support stocks.

LESSON 5: Investing worldwide in stocks and bonds expands opportunities and diversifies assets. Limiting your investments to the US only restricts your ability to maintain purchasing power.

Someone has to pay for this swollen debt structure—most likely in the form of increased taxation. We do not see income taxes going up in 2010. After the 2010 mid-term elections are over we see the politicians swinging into action to pay for their spending spree. As such, you can get out and vote or sit back and enjoy the "wealth redistribution".

LESSON 6: All things being equal, we favor lower taxes. However, an increase in taxes is not the end of the world. If top rates go from 35% to 40% an income earner is still keeping $.60 of every dollar made. It could be worse.

Although we have made significant progress since last spring, the 2010 forecasts for U.S. GDP growth lie between 2.3% and 4%. This is well below the average 6% rate of economic expansion historically seen in the year following a recession. The U.S. economy must grow enough to create jobs for at least some of the 10% who are technically unemployed. Adding insult to injury we estimate that true unemployment is above 17% once you add back in those who are no longer looking for work, those who only work part time, those whose unemployment benefits have run out and those who graduated from college within the last two years (all of those whom the government does not count as "unemployed").

LESSON 7: While the stock market has averaged 9% to 10% over long periods of time, current and projected GDP growth warrants lowering your expectations to 6% or 7% per year over the next 10 years. Despite lowered expectations, this is still a better opportunity for long term investors than other asset classes.

As stated above, the government has spent money like it was going out of style. However, only a quarter of the $787 billion federal stimulus package approved early in 2009 has been spent so far, and the bulk will be deployed next year. When its impact fades in the second half, the government, wisely or not, can extend further aid. We will not be surprised to see an additional $250 billion in stimulus in the next three years.

LESSON 8: Never underestimate a government's ability to spend other people's money. As frustrating as it is to watch citizens tax money spent foolishly, there will be some good to come out of these expenditures.

Much has been made out of what is or is not proposed within the supposed "health care reform" bill that Congress has passed. While we disagree with the governments' constant interference we think that a watered down version will ultimately be passed. The fact that our elected leaders have not read the 2,000 page reform bill that they are voting on is infuriating, but beside the point. Sadly, and more importantly, it appears that many of them voted for this bill simply because of "payoffs" that their special interests received. We do not know what the outcome will be from this bill and think it is less than productive to spend much time on this until we know facts.

LESSON 9: Our elected leaders are for sale to the highest bidder. Although it has probably always been this way, it seems that their questionable behavior is more brazen than ever before.

We end 2009 with a situation that we thought was not only improbable, but nearly impossible—effective 2010 we will have no estate tax—for one year. This situation is as a result of feuding Democrats and Republicans behaving like children. We are guessing that some sort of retroactive patch will be put in place during 2010.

LESSON 10: Our elected leaders often behave like three year olds in need of a spanking.

The income limitation on conversions from a Traditional IRA to a ROTH IRA will be repealed effective January 1st. This conversion opportunity allows an individual to fund money into a ROTH that allows these assets to grow in a tax exempt manner (as opposed to merely tax deferred in a traditional IRA). This conversion also comes at a time when tax rates are historically quite low making the cost of conversion rather attractive.

LESSON 11: Don't overlook the opportunity to set some money aside that is "tax-free" as our elected leaders will increase tax rates at a time that might be rather painful.

Each and every day there will be something to be frustrated or upset over—investing is no different. However, as with all issues there are generally two sides to each equation.

LESSON 12: To all things, there should be balance. Don't let your frustration over taxes, politicians, interest rates etc. blind you from seeing opportunities and making logical decisions.

Finally, as we say goodbye to 2009 we say thank you, again, to our clients. We wish you all a safe and prosperous new year.

Sincerely,

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