

## Investment Perspective

First Quarter 2009

*"If a loose monetary policy and rapid asset price inflation were the route to economic prosperity, Argentina would be the richest country in the world by now" - Albert Edwards*

SFP Core Strategies*	Quarter 1	
	2009	One Year
US S&P 500	-10.86%	-37.78%
US Large Value	-16.79%	-46.64%
US Micro Cap	-16.13%	-40.86%
US Small Value	-17.39%	-44.51%
US Equity Real Estate	-32.69%	-58.79%
International Large Value	-16.15%	-50.98%
International Small Cap	-10.76%	-47.19%
International Small Value	-13.18%	-47.44%
International Real Estate	-17.05%	-58.32%
Emerging Markets	-1.23%	-44.99%
Emerg Mkts Small Cap	-1.44%	-48.01%
Emerging Mkts Value	-2.36%	-50.30%
Ultra Short Fixed Income	0.37%	3.53%
Shrt/Inter Global Fixed Inc	0.09%	3.06%
Inflation Protected Sec	5.14%	-2.51%
<b>Model Portfolios</b>		
SFP Balanced Portfolio	-8.19%	-29.50%
Non SFP Std Balanced	-7.63%	-23.22%

The year began with a nice rally leaving stocks about 4 percent higher just days into the year. That optimism quickly faded as the S&P 500 went on to lose 28 percent of its value and established new closing lows on March 9<sup>th</sup>. From there, in just three short weeks, the S&P 500 gained 18 percent to close out the quarter; a rally that as of this writing continues. A key take away from last quarter's newsletter was that investors should expect large swings in the market, but not to read too much into them; the course could - and would - reverse often.

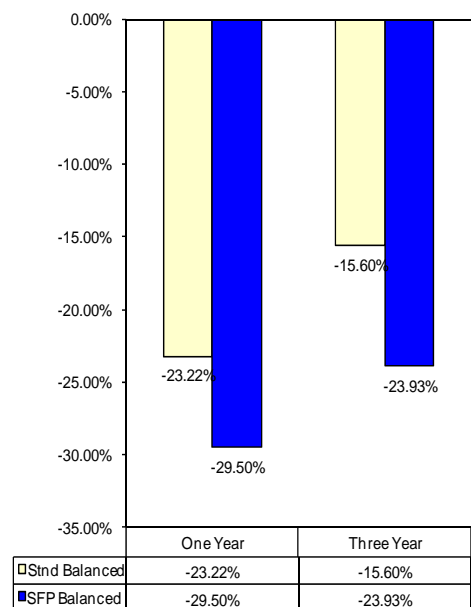
Despite the end of the quarter rally and a more positive tone on Wall Street, stocks did finish the quarter significantly lower. The S&P 500, an index of large company prices, lost about 11 percent, while most other indexes did significantly worse. Interestingly, the Emerging Markets were relatively unscathed.

Our fixed income strategies had a relatively flat performance except for Inflation Protected Securities. These issues that had done poorly in the face of the economic slowdown and possible deflation turned the corner and moved up sharply once more as positive economic news emerged and with the start of massive government spending; both factors that could spell higher consumer prices in the future. (Please see the performance table to the left.)

These moves left the SFP Balanced portfolio, consisting of a diversified mix of 60 percent stocks and 40 percent bonds, down about 8.19 percent for the quarter. This compares to a decline of 7.63 percent for the Non SFP Standard Balanced portfolio. With the SFP's higher weightings in small company stocks and value companies, it will often be the case to see underperformance to the downside and overperformance on the upside. (Please see the comparison chart.)

One common misconception in investing is that stock prices follow economic conditions. At the individual company level, this would mean that a chart of company profits and a chart of company stock prices would follow the same basic pattern. When profits are up, the stock price would be up and vice versa. The same could be expected for overall profit levels and stock prices. If this were the case, market timing would seem quite easy. You simply invest when things are looking good and pull your money out during bad times. Unfortunately, it's not quite that simple.

Standard Balanced vs. SFP Balanced With S&P 500



To illustrate this point, I divided up actual monthly stock market returns from January 1926 through December of 2007 into four groups (measured by the CRSP 1-10 total U.S. Market index and adjusted for inflation). The first group included the returns for all months during time period, the second group included only the monthly returns during non-recessionary times, the third group included only months during the first half of identified recessions and the last group included months during the second half of recessions.

What group would one expect to have the best returns? Intuitively, that must surely be the non-recessionary group, the group with no bad economic times. The more difficult question is when to expect the worst returns. Would it be during the first half of a recession or the second half?

One could argue that the second half would be better for investment, since things are about to turn around. The problem with this thinking is that it's *only known in hindsight*. Remember that in the second half of a recession, economic output is still declining; things are still getting worse and there's no guarantee that an end is coming soon. Furthermore, business risks are actually going up. During the first half of a recession, businesses begin to notice sales slowing and profits falling, but they're not usually desperate. Most have some built up cash reserves and while credit may be tightening, it is usually still available.

During the second half, things are likely to be worse. With sales continuing to fall and cash reserves diminished, credit lines may be cut back and the outlook for survival diminishes. So it might be obvious that the second half of recessions would provide the worst returns – or is it? Here is a table showing the actual results:

1926 - 2007	Average Monthly Return
All Months	0.70 percent
Non-recessionary Months	0.90 percent
First Half of Recessions	-1.77 percent
Second Half of Recessions	1.31 percent

As you can see, the results aren't what you may expect. Investing only during the non-recessionary months produced only slightly better than average returns; the best time to invest was during the second half of recessions when the economic news was at its worst. The 1.31 percent average monthly returns during these times were **nearly double** that of the 0.7 percent during the average of all months during the period.

By no means are we suggesting that we're now entering a period that will produce exceptional returns. I can't even tell you if this sample is statistically significant. I'm no statistician. The point is, that no matter what bad news you hear reported on the evening news, that this company is bankrupt or that economic numbers are disappointing, it doesn't mean it's a bad time to own stocks.

Going forward, the investment basics have not changed. Diversification has never made more sense and you should always invest with appropriate levels of risk for your personal situation and investment time horizon. The Dow Jones may be bouncing around everyday like Miley Cyrus fans at a Hannah Montana concert, but calm, long-term thinking and patience are still sound investment principles.

Have a lovely spring,

*Brian J. Skaggs, CFP*