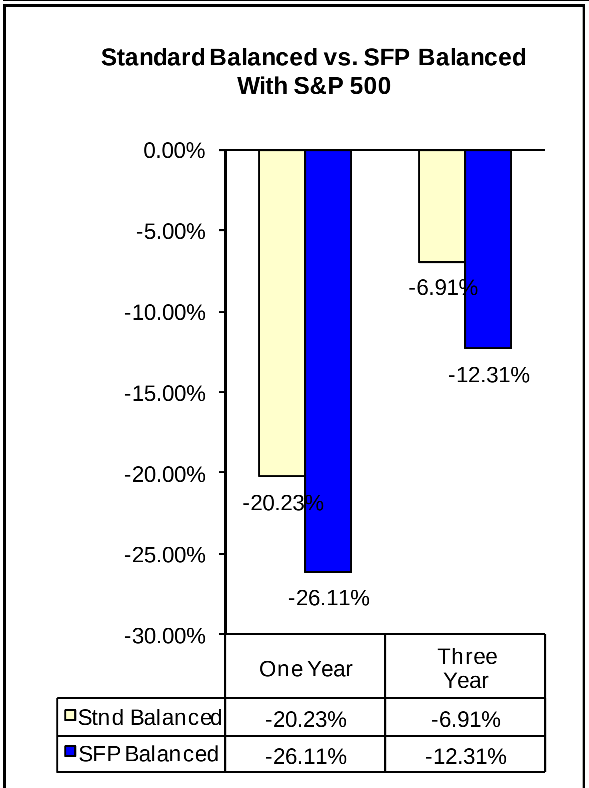
# Investment Perspective

Fourth Quarter 2008

"The true investor welcomes volatility ... a wildly fluctuating market means that irrationally low prices will periodically be attached to solid businesses - Warren Buffett

| SFP Core Strategies* | Quarter 4 2008 | One Year |
|---|---|---|
| US S&P 500 | -21.77% | -36.78% |
| US Large Value | -27.86% | -40.80% |
| US Micro Cap | -26.98% | -36.72% |
| US Small Value | -28.70% | -36.79% |
| US Equity Real Estate | -38.39% | -37.36% |
| International Large Value | -24.43% | -46.33% |
| International Small Cap | -21.42% | -43.87% |
| International Small Value | -19.38% | -41.68% |
| International Real Estate | -33.03% | -51.92% |
| Emerging Markets | -27.83% | -49.20% |
| Emerg Mkts Small Cap | -25.39% | -54.53% |
| Emerging Mkts Value | -28.51% | -53.94% |
| Ultra Short Fixed Income | 2.46% | 4.02% |
| Shrt/Inter Global Fixed Inc | 3.66% | 4.02% |
| Inflation Protected Sec | -2.87% | -1.42% |
| **Model Portfolios** | | |
| SFP Balanced Portfolio | -15.28% | -26.11% |
| Non SFP Std Balanced | -9.46% | -20.23% |




During times like this, investors want answers. We want to know if the worst is behind us, how to avoid further losses and the best way to move forward. While we would like answers to these questions, most of us realize no sure answers are available. But we at Skaggs Financial Planning, LLC believe there are a few things that investors can expect in the near term. We hope that these can provide some guidance and confidence moving forward.

First, a quick review of 2008's wreckage.

The collapse in stock prices during 2008 was horrific. As measured by the S&P 500 index, prices were down 37 percent for the year. This amounts to the worst calendar return for the U.S. stock market since 1931. The destruction in the overseas market was even greater. It is fair to say that the values of the world's businesses were nearly cut in half in 2008. Considering the action overseas, it was arguably the worst January through December period in the history of modern stock markets. (Please see the performance table - if you must.)

On a relative basis, the SFP Balanced Portfolio fared poorly. During 2008, this portfolio lost a bit over 26 percent, pulling its three-year returns into the red – a 4.28 percent loss. This compares with a one-year loss of 20.23 percent and a three-year decline of 2.36 percent for the Non SFP Balanced portfolio. This difference was mainly due to a heavier weighting in the overseas markets and shorter average maturities on the bond side. (Price appreciation for government bonds has soared due to the so-called "flight to safety.")

We suspect that in real world portfolios, we're probably doing better than most. The Non SFP Balanced Portfolio uses a combination of DFA funds as a proxy for how other funds may be performing. It's only the allocation that differs. While this allows us to get timely and consistent data for this newsletter, these funds aren't available to the general public and only a tiny portion of advisors are approved to use them.

With the scale of losses along the lines of those incurred during the 1930s, it's not surprising that many have compared current conditions to the Great Depression. But we think a full-scale depression is unlikely.

10932 Rainier Ave S. • Seattle, Wa 98178 • 206.330.2161 • Fax: 206.260.2780

Today's understanding of economic downturns and the system for dealing with them are much better. It is hard to believe now, but during the Great Depression, taxes and interest rates were actually increased. We were still on a gold standard and the government couldn't just fire up the printing presses and start spending money on bailouts or stimulus packages.

Still, there are concerns. Past depressions have been brought on by credit and asset bubbles similar to those we have experienced in the mortgage and housing markets. Run-of-the-mill recessions are generally brought on by standard business cycles or tight money supply; we know that this is something more.

The bubble inflated home and portfolio values, and many of us felt a bit wealthier than we were. Most of us spent accordingly, something seen around the globe. On a macro level, this meant that the world economy was larger than it should have been. It was producing an amount to satisfy our inflated spending. Now we are all of us reassessing our true wealth, and we're spending less; an appropriate response. We don't view this decline in spending as a purely temporary. If we're right, this means that the world economy must get smaller before growth can resume.

Governments around the world are of course doing their best to prevent any economic contraction from spiraling out of control as it did during the Great Depression. Our feeling is that they will be successful in stopping the spiral, but we fear that they may be overzealous. There should be attempts to restore confidence and avoid panic while still realizing that some economic pain is in order.

We also believe that expected returns for the stock market have increased. Identifying expected returns on risky assets is always a little murky. We do know that people invest in stocks rather than Treasury Bills or bank CDs for extra return. But knowing how much extra return is demanded or how that number may fluctuate over time isn't clear. Murky or not, we believe that this number does change with time and that it's now higher than it has been for many years.

Economic times will be tough but that doesn't mean that stocks must. To put it simple: the market could easily go up even in the face of bad news. But don't read too much into short term upswings. We think expected returns are higher now, but we do not think investors should be surprised to see continued volatility in the near term. Historically, volatility has led to more volatility. The market does not follow any rulebooks, but it just makes sense to expect more.

There are no guarantees that expected returns will materialize and there never will be. We also think it is foolish to believe that this market will bounce right back or that now is a good time to speculate on possibly underpriced stocks. That said, the word investment does imply some level of commitment and we do believe that those willing to endure some choppy times will be rewarded.

Wishing you the best for 2009,

*Brian J. Skaggs, CFP*