



# Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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## MARCH 2009 COMMENTS

### MARCH 2009 MARKET ACTIVITY (ending Tuesday, March 31st)

During the month of March, US and INTERNATIONAL STOCK prices hit new lows as of March 9<sup>th</sup>, then rallied to close higher for the month, but are still down substantially for the year to date. (Figures for the month and YTD are on page 2; figures tracking the many new lows since the end of 2006 are presented on page 5). Whether the improved stock prices continue, based on an improving economy and financial conditions, or whether the March recovery proves as brief as other recoveries during the past few years, remains to be seen. (See discussion starting on page 6 relating to trying to call market bottoms or predicting the future direction of stock prices).

BOND prices posted modest gains, with inflation-protected and high yield bonds posting larger gains. (Month and YTD Bond results are on page 2).

All markets continue to take their major cues from government actions intended to improve the economy and the financial system. Success or failure of these programs is the key to improving stock and bond prices. A reading of the history of the years in which the American economy experienced its "Great Depression" shows that many programs were tried, some succeeded, and some did not. That may well be the case in these times.

As you know, we are major proponents of the view that investing is a long-term process, that no one knows in advance when markets will enter periods of significant declines and/or significant gains, and that staying the course with an appropriately allocated investment portfolio is the preferred approach, compared to trying to outguess the market's moves. The discussion starting on page 6 reviews various alternatives available to investors.

### CONTENTS

Page 1: Market Activity for March

Pages 2-4: Index Results for MARCH 2009, and Year-to-Date 2009;

Also Years 1999 – 2008, and Various Other Longer Time Periods

Pages 5-10: Investment Concepts:

Page 5: Highs and Lows in Stock Prices Since Year End 2006

Pages 6-7: I. Basic Allocation Alternatives Available for Your Investments

Pages 7-10: II. Some Lessons Learned/Relearned Amidst the Current Downturn

*Any recommendation contained in these Comments may not be suitable for all investors. Moreover, although the information contained herein has been obtained from sources believed to be reliable, its accuracy and completeness cannot be guaranteed.*

**COMMENTS: INDEX RESULTS for period ending MARCH 2009**

|  | YEAR        | YEAR          | YEAR          | YEAR        | YEAR        | YEAR        | YTD         | MAR.        |
|--|-------------|---------------|---------------|-------------|-------------|-------------|-------------|-------------|
|  | <u>1999</u> | <u>2000-2</u> | <u>2003-5</u> | <u>2006</u> | <u>2007</u> | <u>2008</u> | <u>2009</u> | <u>2009</u> |
| <b>STOCKS</b>                              |             |               |               |             |             |             |             |             |
| Vanguard Total Stock Market Index Fund     | 23.8%       | -37.2%        | 53.1%         | 15.5%       | 5.5%        | -37.1%      | -10.7%      | 7.1%        |
| Standard & Poor's (S&P) 500 Index          | 19.6%       | -40.1%        | 41.9%         | 13.6%       | 3.5%        | -38.5%      | -11.7%      | 6.9%        |
| Vanguard S&P 500 Growth Index Fund         | 28.8%       | -48.4%        | 41.8%         | 9.0%        | 12.6%       | -38.4%      | -4.2%       | 7.4%        |
| Vanguard S&P 500 Value Index Fund          | 12.6%       | -26.2%        | 63.2%         | 22.1%       | 0.1%        | -36.1%      | -16.4%      | 6.9%        |
| Dow Jones Industrial Average Index         | 25.2%       | -27.5%        | 28.5%         | 16.3%       | 6.4%        | -33.8%      | -13.3%      | 6.2%        |
| NASDAQ Composite Index                     | 85.6%       | -67.2%        | 65.2%         | 9.5%        | 9.8%        | -40.5%      | -3.1%       | 9.5%        |
| Vanguard Midcap US Index Fund              | 25.0%       | -18.3%        | 83.9%         | 13.6%       | 6.0%        | -41.8%      | -8.5%       | 7.4%        |
| Vanguard Smallcap US Index Fund            | 19.6%       | -24.2%        | 87.5%         | 15.6%       | 1.2%        | -36.1%      | -13.5%      | 7.5%        |
| Vanguard International Index Fund (EAFE)   | 25.3%       | -45.9%        | 95.9%         | 26.6%       | 15.5%       | -44.1%      | -13.0%      | 7.4%        |
| Vanguard Emerging Markets Index Fund       | 61.6%       | -29.5%        | 162.7%        | 29.4%       | 39.0%       | -52.9%      | 0.1%        | 13.9%       |
| Vanguard Real Estate Investment Trust Fund | -0.4%       | 47.5%         | 98.6%         | 35.1%       | -16.5%      | -37.2%      | -32.1%      | 2.4%        |
| <b>BONDS</b>                               |             |               |               |             |             |             |             |             |
| Vanguard Short-term Bond Index Fund        | 2.1%        | 25.8%         | 6.5%          | 4.1%        | 7.2%        | 5.4%        | 0.5%        | 0.7%        |
| Vanguard Short-term Tax-Ex. Bond Fund      | 2.6%        | 13.8%         | 4.5%          | 3.2%        | 4.2%        | 3.7%        | 1.1%        | 0.2%        |
| Vanguard Total Bond Market Index Fund      | -0.8%       | 30.4%         | 11.1%         | 4.2%        | 6.9%        | 5.1%        | 0.3%        | 1.4%        |
| Vanguard Interm-term Tax- Ex. Bond Fund    | -2.9%       | 23.7%         | 10.3%         | 4.4%        | 3.4%        | -0.1%       | 3.0%        | -0.2%       |
| Vanguard High-Yield Bond Fund              | NA          | 1.7%          | 30.7%         | 8.2%        | 2.0%        | -21.3%      | 4.6%        | 2.0%        |
| Vanguard High-Yield Tax-exempt Bond Fund   | -3.4%       | 25.2%         | 16.5%         | 5.5%        | 1.6%        | -10.5%      | 5.3%        | -0.4%       |
| Vanguard Inflation-Protected Bond Fund     | NA          | 25.5%         | 20.0%         | 0.4%        | 11.6%       | -2.9%       | 5.2%        | 5.9%        |

NOTE 1: Current Month Results measured from beginning of year, and not beginning of prior month.

NOTE 2: Three-year results start with a base of 100, and after each year's % change, the result for that year creates a new base. So if at the end of the first year the index is up 10%, then the new base is 110%; and if down 10%, then the new base is 90%. NOTE also that a decline of 50% requires a gain of 100% to get back to the starting value, which explains why NASDAQ, down 67%, would require a gain of 200% to get back to its starting value.

- 1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.
- 2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

| %                  | 1Q     | 2Q          | 3Q     | 4Q     | 1Q     | 2Q     | 3Q          | 4Q     | 1Q     | 2Q    | 3Q     | 4Q          |  |  |  |
|--------------------|--------|-------------|--------|--------|--------|--------|-------------|--------|--------|-------|--------|-------------|--|--|--|
|                    |        | <u>1999</u> |        |        |        |        | <u>2000</u> |        |        |       |        | <u>2001</u> |  |  |  |
| <b>S&amp;P 500</b> | 4.1    | 7.6         | (7.7)  | 15.6   | 2.0    | (3.0)  | (1.3)       | (7.8)  | (12.1) | 4.8   | (13.8) | 8.1         |  |  |  |
| <b>NASDAQ</b>      | 14.6   | 10.0        | 0.0    | 61.0   | 12.4   | (14.8) | (7.2)       | (29.6) | (25.5) | 12.9  | (26.7) | 18.3        |  |  |  |
| <b>BONDS</b>       | 0.0    | (0.5)       | 0.4    | (0.7)  | 2.4    | 1.5    | 3.1         | 4.3    | 3.2    | 0.8   | 4.3    | 0.0         |  |  |  |
|                    |        | <u>2002</u> |        |        |        |        | <u>2003</u> |        |        |       |        | <u>2004</u> |  |  |  |
| <b>S&amp;P 500</b> | 0.0    | (13.8)      | (14.1) | 4.5    | (1.8)  | 12.8   | 2.2         | 13.2   | 1.3    | 1.3   | (2.4)  | 8.8         |  |  |  |
| <b>NASDAQ</b>      | (5.5)  | (19.5)      | (13.5) | 7.0    | 2.5    | 19.2   | 12.1        | 16.2   | (0.5)  | 2.7   | (7.5)  | 13.9        |  |  |  |
| <b>BONDS</b>       | 0.0    | 2.8         | 3.6    | 1.8    | 0.9    | 2.7    | 0.2         | 0.2    | 2.7    | (2.6) | 3.1    | 1.0         |  |  |  |
|                    |        | <u>2005</u> |        |        |        |        | <u>2006</u> |        |        |       |        | <u>2007</u> |  |  |  |
| <b>S&amp;P 500</b> | (2.6)  | 0.9         | 3.1    | 1.6    | 3.7    | (1.9)  | 5.2         | 6.6    | 0.2    | 5.8   | 1.6    | (4.1)       |  |  |  |
| <b>NASDAQ</b>      | (8.1)  | 2.6         | 4.4    | 2.5    | 6.1    | (7.6)  | 3.9         | 7.1    | 0.3    | 7.5   | 4.0    | (2.0)       |  |  |  |
| <b>BONDS</b>       | (0.5)  | 3.0         | (0.7)  | 0.6    | (0.7)  | (0.2)  | 3.8         | 1.3    | 1.4    | (0.6) | 2.9    | 3.2         |  |  |  |
|                    |        | <u>2008</u> |        |        |        |        | <u>2009</u> |        |        |       |        | <u>2010</u> |  |  |  |
| <b>S&amp;P 500</b> | (9.9)  | (2.9)       | (7.9)  | (17.7) | (11.7) |        |             |        |        |       |        |             |  |  |  |
| <b>NASDAQ</b>      | (14.1) | 0.6         | (8.0)  | (19.0) | (3.1)  |        |             |        |        |       |        |             |  |  |  |
| <b>BONDS</b>       | 2.2    | (1.1)       | (0.5)  | 4.5    | 0.3    |        |             |        |        |       |        |             |  |  |  |

**STOCK** index prices for US and International indexes gained during March, but declined for the sixth consecutive calendar quarter (see quarterly chart above). The monthly gains ranged from 6.2% (Dow Industrials) to 9.5% NASDAQ Composite to 13.9% Emerging Markets. The YTD figures range from breakeven for Emerging Markets, to down 3.1% for the NASDAQ Composite, to down 13.3% for the Dow Industrials, with the Growth sector greatly outperforming Value and the REIT sector as the major decliner.

**BOND** returns (price change plus interest) were modestly higher in March and YTD, with inflation-protected and high yield bonds showing larger gains. The benchmark 10-year US Treasury yield closed at 2.69%, which was 34bp lower than February, but 44bp higher than December's historically low close of 2.25%. Short-term US Treasury yields remained at almost zero, as the Federal Reserve kept its short-term rates at that level. In general, as interest rates move lower, prices for existing bonds rise. During September-November 2008, however, the credit quality issues impacting various parts of the credit markets altered this normal relationship of interest rates and prices. However, the December 2008-March 2009 period has shown a return to more normal bond pricing.

**ECONOMIC NEWS** continued mostly negative, with "the unemployment rate reaching its highest level since 1983...after several weeks of economic data,... such as stronger housing demand (albeit with falling prices), and a rebound in consumer spending...offering some hope that the economy may be approaching bottom" (WSJ, 4/4-5, front page). The key question now is the recession's duration and severity, since it has spread internationally as well. The answer appears to depend on the success of governments' efforts at economic stimulus and restoring the banking system to some degree of normalcy. Positive news included continuing low oil prices and inflation. While there is some discussion of possible deflation, governments' huge infusions of money into various programs designed to reignite economic activity are likely to add to inflation at a future time.

From a longer-term standpoint, the stock price declines from the October 2007 highs accelerated dramatically starting in September 2008 and reached lows in early March 2009, with the declines approaching 60% from the 2007 highs. The subsequent March 2009 rally brought those declines closer to 50% (see pg. 5 chart). From 2000 through March 2009, the Dow Industrials are now 35% lower, the S&P 500 48% lower, and the NASDAQ a stunning 70% lower. The decade of the 2000s is almost certain to be the first since the 1930s with cumulative annualized negative stock returns, making these returns obviously far lower than their positive long-term average annualized returns of 9.6% (a figure recently updated by Ibbotson/Morningstar to cover 1926 through 2008). Going back to the bull market that began in 1995, all three major indexes have similar (and, since September 2008, very much lower) average annual returns, ranging from 4.0% to 5.1%. The mutual fund company Vanguard notes that from 1926 through 2008, in only six of 83 years did stock prices fall within 2%, up or down, of the long-term annual average return of 9.6%.

**The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, even with (so far) a fairly stable very-long-term average return. Key Questions: Your relevant time frame and tolerance for risk.**

|                        | <u>S&amp;P 500 (1)</u> |       | <u>DOW (1)</u> |       | <u>NASDAQ (1)</u> |       |
|------------------------|------------------------|-------|----------------|-------|-------------------|-------|
| 1st Qtr 2000 High      | 1,527                  |       | 11,723         |       | 5,048             |       |
| Year End 2000          | 1,320                  | (13)% | 10,785         | (8)%  | 2,470             | (51)% |
| September 21, 2001 Low | 965                    | (37)% | 8,235          | (30)% | 1,425             | (72)% |
| Year End 2001          | 1,148                  | (25)% | 10,020         | (17)% | 1,950             | (61)% |
| October 9, 2002, Low   | 777                    | (49)% | 7,286          | (38)% | 1,114             | (78)% |
| Year End 2002          | 880                    | (42)% | 8,342          | (29)% | 1,336             | (73)% |
| Year End 2005          | 1,248                  | (18)% | 10,718         | (9)%  | 2,205             | (56)% |
| Year End 2007          | 1,468                  | (4)%  | 13,265         | +13%  | 2,652             | (47)% |
| November 20, 2008, Low | 752                    | (51)% | 7,552          | (36)% | 1,316             | (74)% |
| December 31, 2008      | 903                    | (41)% | 8,776          | (25)% | 1,577             | (69)% |
| March 9, 2009 Low      | 677                    | (56)% | 6,547          | (44)% | 1,269             | (75)% |
| March 31, 2009         | 798                    | (48)% | 7,609          | (35)% | 1,529             | (70)% |

**Context: Prior Five-Year Gains in Bull Market of 1995 - 1999**

|                                       | <u>S&amp;P 500 (1)</u> | <u>DOW (1)</u> | <u>NASDAQ (1)</u> |
|---------------------------------------|------------------------|----------------|-------------------|
| End 1994                              | 459                    | 3,834          | 752               |
| End 1999                              | <u>1,470</u>           | <u>11,500</u>  | <u>4,070</u>      |
| Gain                                  | 1,011                  | 7,666          | 3,318             |
| Avg. Ann. % Gain: '95-'99; 5 years    | 26.2%                  | 24.6%          | 40.2%             |
| March 2009                            | 798                    | 7,609          | 1,529             |
| Gain                                  | 339                    | 3,775          | 777               |
| Avg. Ann. % Gain: '95-3/09; 14.25 yrs | 4.0%                   | 4.9%           | 5.1%              |

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's fees.

## INVESTMENT CONCEPTS

The chart below has been updated monthly to reflect the extreme stock market volatility since the summer of 2007. What appeared extreme in late 2007 and early 2008, however, has turned out to be a mild prelude to the declines of Sep.-Nov. 2008, and Jan.-Feb. 2009.

|                               | <u>S&amp;P</u><br><u>500</u> | <u>Change</u><br><u>from</u><br><u>YE06</u> | <u>Dow Jones</u><br><u>Industrials</u> | <u>Change</u><br><u>from</u><br><u>YE06</u> | <u>NASDAQ</u> | <u>Change</u><br><u>from</u><br><u>YE06</u> |
|-------------------------------|------------------------------|---|--|---|---------------|---|
| YE 2006                       | 1,418                        | -   | 12,463                                 | -   | 2,415         | -   |
| 10/9/07 High                  | 1,565                        | 10.4%                                       | 14,165                                 | 13.7%                                       | 2,859         | 18.4%                                       |
| 12/31/07 Close                | 1,468                        | 3.5%  | 13,265                                 | 6.4%  | 2,652         | 9.8%  |
| 1/22-23/08, and<br>3/17 Lows* | 1,257                        | -11.3%                                      | 11,635                                 | -6.6%                                       | 2,155         | -10.8%                                      |
| 5/31/08 Close                 | 1,400                        | -1.3%                                       | 12,638                                 | 1.4%  | 2,523         | 4.5%  |
| 10/10 & 24 Lows*              | 840                          | -40.7 %                                     | 7,882                                  | -36.7%                                      | 1,494         | -38.1%                                      |
| 10/31/08 Close                | 969                          | -31.7%                                      | 9,325                                  | -25.2%                                      | 1,721         | -28.7%                                      |
| 11/21/08 Low*                 | 741                          | -47.7%                                      | 7,449                                  | -40.2%                                      | 1,295         | -46.4%                                      |
| 12/31/08                      | 903                          | -36.3%                                      | 8,776                                  | -29.6%                                      | 1,577         | -34.7%                                      |
| 3/9/09 Low*                   | 677                          | -52.2%                                      | 6,547                                  | -47.5%                                      | 1,269         | -47.5%                                      |
| 3/31/09                       | 798                          | -43.7%                                      | 7,609                                  | -39.0%                                      | 1,529         | -36.7%                                      |

\* Note – These are not closing prices, but "intra-day" lows

Some key observations from the chart:

- 1) From the October 2007 highs to the new March 9, 2009 lows, all three major US indexes were down a huge 60% to 65%, far exceeding the declines of 1973-74 and 2000-2.
- 2) October 2007, May 2008, and the last week in October 2008 were all periods of price recoveries of 10% or more. The December 2008 price recovery, measured from the November lows, ranged from 18% to 22%, but the most recent January-March 9<sup>th</sup> declines eliminated all these gains and reached new lows. Last month's recovery from the March 9<sup>th</sup> lows ranged from 16% to 20% The recoveries illustrate the dangers of exiting the stock market after periods of substantial declines on the assumption the declines will continue, and also about using periods of gain as entry points. During this bear market, with the benefit of hindsight, no rally up to now would have been a good entry point.

- 3) Even knowing what we know now about the severity of this bear market, there is no way to determine, before the fact, at what point the lows for this market cycle will have been reached until long after the cycle has been completed (see discussion which follows).

## **I. Basic Allocation Alternatives Available for Your Investment Portfolio**

As another month has passed with (1) no clear evidence of improvement in either economic activity or financial stability; and (2) most stock and bond prices still below year-end 2008 levels, it seems worth reviewing the various alternatives open to you as investors:

- A. Maintain your basic allocation between safer income-producing investments (namely money markets, CDs, short- and intermediate-term bond funds with high credit quality, including inflation-protected), and riskier investments with potential for greater future gains and/or declines (stock market investments, and higher-yielding income-oriented investments with greater credit risk). To take this position, you should meet two basic criteria, as follows:
  - 1) You believe the economy and financial system are likely to recover, in some reasonable time frame, based on the combination of government actions and/or the normal cyclical flow of our economic system; and
  - 2) You have sufficient money allocated to the safer, income-producing part of your portfolio to meet at least three to five years of normal spending requirements from your investment portfolio. If your accumulated capital can generate enough money for many years of spending needs, with investments in the safer part of the markets, then we encourage an allocation that reflects this fact. If spending needs are greater than what can be earned from a substantial allocation to the safer investments, you may need to consider adding to the riskier investments, in the hope of generating a greater return. Alternatives include reducing your spending needs or generating additional income from sources other than your investments.
- B. Reduce your allocation to the riskier investments, and add to the safer investments. This reduces your opportunity to participate in the recovery of the value of whatever investments are sold, but it does create more stability for your portfolio and reduces the chance for further declines. This should be considered if:
  - 1) You do not have confidence that there is likely to be a meaningful recovery within some reasonable time period; and
  - 2) Your withdrawal needs from your portfolio are such that you can manage on the lower, more stable returns that come from the safer investments.

- C. Rebalance back to the higher percentage of riskier investments that you had as of September 2008 (almost all riskier investments are down significantly in price since then, and therefore make up a smaller percentage of your portfolio now than these same investments did at that time). The basic idea here is to buy when prices are lower, which means you need to believe there is a strong likelihood of a meaningful recovery in a reasonable time frame, and that the historically higher returns associated with riskier investments are likely to be realized over time.
- D. Another alternative, which we do not advocate, and believe cannot be done successfully, is to try and time the market moves, so that you are invested when prices are rising and out of the markets when prices are declining. Our experience, and the professionals and academics whose views we believe are worth considering, strongly suggests that efforts to time the markets do not produce favorable results consistently over time.

## **II. Some Lessons Learned/Relearned Amidst the Current Downturn**

Since this recent period of economic recession, financial instability, and severe market declines in riskier investments (including some income-oriented investments thought to be less risky) has shaken the confidence of almost all investors, a review of some of the lessons presented by these conditions should be helpful in providing a context for making decisions regarding the alternatives set out in A. through C. above.

(1) History may not repeat, and the future is truly unpredictable. “The fact is that we as humans cannot tell the future. It does not matter whether you are Jim Cramer or if you are Warren Buffett, an off-the-charts genius on a scale rarely seen. It does not matter if you are Milton Friedman or Paul Samuelson or James Tobin, all Nobel Laureates. Human beings cannot tell the future, or at least cannot tell it in any consistent way. Humans can’t consistently pick the right stocks or call markets, foretell political events or successfully predict changes in interest rates or commodity prices. Life is far too complex and baffling for the minds of mortals to understand it as it happens, let alone to predict it accurately....(To quote Professor Freidman, “if you are going to predict, predict often.”).....Some humans shine like dazzling stars when their predictions turn out to be true, but those same humans can’t ever be counted on to replicate the feats regularly....Who would have guessed that we would have a fall of more than 50% in the broad stock indexes or that oil would triple in price and then fall by more than \$100 a barrel? Some people might have seen parts of this pattern, but all of it? Again, life is far too complex to be predicted with any consistency” (Ben Stein, NY Times Sunday Financial section, 3/29/09, pg. 2). We agree completely.

In a fascinating article in the same NY Times Financial section (pg. 5), Mark Hulbert writes that new research is challenging the notion that the stock market is likely to continue to produce handsome long-term returns, as it has historically. He cites studies showing that “stocks have, over periods of 30 or more years, almost always outperformed other asset classes, and that the stock market’s long-term returns have tended to fall within a surprisingly narrow range. But those studies were based on the stock market’s past performance, which famously, provides no guarantee of future performance. New research, using different statistical techniques aimed at capturing the uncertainty of future returns, suggest that the market may be much riskier than many investors have understood.”

(Our note: this should come as no surprise to our regular readers, since we have cited Nick Taleb and his books and articles many times. Taleb he has consistently warned against using the past as a predictor of the future, given the possibility/likelihood of “black swan,” i.e., major unpredictable, events).

Hulbert's article continues with a discussion of mean reversion, the historical fact that “the stock market's returns over various 30 year periods have been surprisingly consistent, with periods of particularly good returns followed by subpar ones, and vice versa.” Mean reversion has been at work in the US stock market all the way back to 1802 (according to Prof. Jeremy Siegel of Wharton, author of “Stocks for the Long Run.”). The new research, using Bayesian analysis (named after an 18<sup>th</sup> century mathematician, Thomas Bayes, whose “analysis is often used to assess the uncertainty of future outcomes, based on a formula for updating the probabilities of given events in the light of new evidence),... found that reversion to the mean is not powerful enough to overcome the growing uncertainty caused by other factors as the holding period grows.... Traditional research ignores uncertainty about what the average return might itself turn out to be.... And what about Prof Siegel's finding that the stock market has produced an average inflation adjusted return of close to 7% since 1802?... The professors of the new research say that the last two centuries could easily have been less hospitable to the US, most likely lowering the stock market's return. An investor could not have known in advance the US would win two world wars, or emerge victorious from the cold war. In any case, there is no guarantee that the next two centuries will be as kind to the domestic equity market as the last two.... What is the investment implication of the new study. Other things being equal, you should probably lower your portfolio allocation to stocks. But by how much? It's impossible to generalize, since the answer depends on your time horizon and what else is in your portfolio.”

So at the end of this fascinating material, we are left once again with trying to develop an asset allocation appropriate to each person's circumstances, but with less reliance on the stock market delivering their historically favorable returns. Further, we are reminded, again and again, about the futility of making predictions, and of believing that the history that we know is bound to, or even likely to, repeat. Another quote on this, from John Kenneth Galbraith: “I am cautious about prediction; I discovered years ago that my correct predictions are forgotten, the others meticulously remembered.” Even more dangerous, in this day and age when the predictor who gets it right becomes a media hero (for example, the aforementioned Nick Taleb and Professor Nouriel Roubini of NYU, who correctly predicted the mortgage crisis and resulting financial and economic grief that has followed), it takes some degree of discipline not to believe that everything that person subsequently has to say on these subjects is likely to come to pass.

(2) The people we believed were “experts” really did not know the consequences of many of the policies they either developed or allowed to develop. The number one example for us is former Federal Reserve Chairman Alan Greenspan.

Unlike bankers, or Wall Street financiers, or CEOs of large companies, all of whom have clear agendas in support of their respective business interests, Greenspan was thought of as the truly independent financial expert of our time. He served in both Republican and Democratic administrations, so he had no clearly apparent political agenda. He had (or we certainly thought he had) major expertise in economic and financial matters. And yet, he was the one who assured us that diversifying risky leveraged assets reduced the risks that these assets presented to the financial system, who set the stage (with very low interest rates) for the huge borrowing of the mid 2000s, and who assured us that any problems that arose from these policies could be managed and contained. What we have subsequently learned is that the policies were faulty, and that the assurances were worthless. Now if Alan Greenspan doesn't know the consequences of certain financial/economic policies, then who does? And so, the limitations of so-called "experts" should become a new and important lesson to be drawn from our current problems.

The larger issue becomes, on whom can we rely? The people who predicted that low interest, easy money policies would lead to serious problems, such as the aforementioned Prof. Roubini from NYU, become the new "experts." But should we believe that they are likely to continue to be correct in their views going forward? In its Sunday Opinion Page (3/1/09, pg. 12), the NY Times ran an article titled "When Will the Recession Be Over," with Roubini as one of eleven "experts" cited. As you might imagine, opinions varied on the question posed, ranging from the end of 2009 to the middle of 2013 and beyond. (Roubini's answer actually varied within itself, depending on whether certain future events occur or not). Another of the respondents, long time financial observer James Grant, added the sarcastic observation that it will be over "when you stop asking when it will be over," and then added, in line with the previous section in these Comments, that "nobody knows, or could know." And yet, the articles are written, the "experts" predict, and we tend to choose the point of view that most closely coincides with our own. Given the divergence of opinion from the "experts," it seems fair to conclude that "experts" are not that much help

Another example of the experts delivering disappointment is the difficulty that both the Bush and Obama administrations had, and are continuing to have (with Henry Paulson and Timothy Geithner as Treasury Secretaries, working in concert with the current Fed Chairman Ben Bernanke), in developing a plan to rid the banks of their so-called "toxic" assets. (These are the overleveraged, uncollectable mortgages and other loans that have driven the banks to the verge of insolvency and, in some cases, beyond, requiring massive government infusions of capital). All this expertise, and yet no clear, workable solution has yet to emerge.

So who can we rely on? We believe there are no experts on whom we can rely, and that only the unfolding of the actual events will tell us which views were correct. Otherwise, healthy skepticism should prevail. In Thomas Friedman's most recent article (NY Times, Week in Review, 4/5/09, pg. 10), he writes that Franklin Roosevelt, in the midst of the Great Depression, stated that "The country needs...bold, persistent experimentation...It is common sense to take a method and try it. If it fails, admit it frankly and try another. But above all, try something."

The article continues that “when you total up all the emergency economic policies that are now in place – a nearly \$800 billion stimulus, mortgage relief, a private-public program for buying up toxic assets, and a huge capital injection into the banking system by the Federal Reserve to lower interest rates and expand credit – they constitute one big experiment....From the left, Obama is being ripped for having too much of a market based approach, ... and from the right, he is being ripped for too much government intervention....The success of the approach will depend on everything working together, that the fiscal stimulus will improve the housing markets by creating more employment and growth, the improvement in housing will take pressure off the banks and less pressure on the banks will improve the availability of credit that will help housing and business job creation. That is the president's first big Rooseveltian experiment.” We agree with Freidman's characterization, that all these policies are essentially experiments, and that even the experts putting all these programs together do not really know the outcome. (If you are interested in reading about all the experiments and disagreements in policy that occurred during Roosevelt's time, which makes the current period look harmonious, we refer you to Elliot Rosen's “The Great Depression, and the Economics of Recovery.” We are likely to refer to this source in future Comments).

(3) Investors are not entitled to the highest value their accounts ever reached, so long as they continue to invest in markets that carry risk. This notion was best articulated by David Swensen, the Chief Investment Officer of Yale's endowment, and a frequent source for our approach to investing. Even Warren Buffett, acknowledged as the great investor of our time, saw his investment portfolio decline by over 25% in 2008. So many great corporate names of prior times have been humbled, and reduced to tiny fractions of their prior market value, such as General Electric, Citibank, and General Motors.

What conclusions can we draw from all of this? We know that: (1) the future is unknown and unpredictable, and that the history we know may not repeat; (2) the “experts” we have been relying on have proven quite fallible; and (3) there is real risk to market investments. We see conflicting opinions and advice, and need to deal with our own fears about the future and our ongoing financial objectives. The pivotal question then is, WHAT DO YOU DO NOW? This is always the key question, since it involves taking a position on the future, and what you believe is likely to happen, even knowing what has already happened, and knowing that what has happened offers little assistance in figuring out what is going to happen. Unsettling as this message is, it also seems to us to be accurate. The hopeful notes we would end on are: (1) the Obama administration, and other governments world-wide, have taken a number of steps in an effort to solve the current economic and financial problems; and (2) relying on the long-term economic growth of the world's economies, based on meeting new and ongoing needs with new technologies, has provided favorable past results, and has the potential (no assurances, of course) to do so again.



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