Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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JUNE 2009 COMMENTS

JUNE 2009 MARKET ACTIVITY (ending Tuesday, June 30th)

During the month of June, US and INTERNATIONAL STOCK prices had mixed results. YTD results showed a wide range, while all stock categories have made huge percentage gains since their March 9th lows. International and Emerging Markets continued to outperform most US indexes, exactly the reverse of 2008 results. (For month and YTD figures, see page 2; for figures tracking the volatility in stock prices since the end of 2006, see page 5.)

BOND prices of high credit quality bonds were mostly modestly higher. US Treasury prices steadied, as interest rates on the benchmark 10-year bond closed at 3.54%, up a slight 7 bps from May's close, but far higher than December's historically low close of 2.25%. These rates were lower than the intra-month high of 3.94%. (Typically, bond prices decline as interest rates rise, and prices rise as rates decline, absent credit concerns). The high credit quality corporate bond market, as well as the low credit quality "junk bond" market, continued to post substantial gains, outperforming a mix of safer, lower yielding, government-corporate bonds (month and YTD results are on page 2).

NOTE: Regarding SCHWAB NOTICE of Preferred Stock exchange. During the month, Schwab sent notices to a number of our clients regarding preferred stock exchanges. In most cases, the notice stated "Per your request, your Investment Manager has not been sent any information regarding this Notice." Many clients questioned this wording, as they had made no such request. Suffice to say, we have discussed this unfortunate wording with Schwab, and we do have information on all such potential transactions affecting your portfolio.

In terms of the substance of the notice, you can simply ignore it. The exchange offer of the Citigroup and Bank of America common stock for the preferred was not accepted for any clients, and doing nothing was the correct response to the offer.

COMMENTS: INDEX RESULTS for period ending JUNE 2009

	YEAR 1999	YEAR 2000-2	YEAR 2003-5	YEAR 2006	YEAR 2007	YEAR 2008	YTD 2009	JUNE 2009
STOCKS								
Vanguard Total Stock Market Index Fund	23.8%	-37.2%	53.1%	15.5%	5.5%	-37.1%	4.4%	0.4%
Standard & Poor's (S&P) 500 Index	19.6%	-40.1%	41.9%	13.6%	3.5%	-38.5%	1.8%	0.0%
Vanguard S&P 500 Growth Index Fund	28.8%	-48.4%	41.8%	9.0%	12.6%	-38.4%	10.7%	1.5%
Vanguard S&P 500 Value Index Fund	12.6%	-26.2%	63.2%	22.1%	0.1%	-36.1%	-2.4%	-0.8%
Dow Jones Industrial Average Index	25.2%	-27.5%	28.5%	16.3%	6.4%	-33.8%	-3.8%	-0.7%
NASDAQ Composite Index	85,6%	-67.2%	65.2%	9.5%	9.8%	-40.5%	16.4%	3.9%
Vanguard Midcap US Index Fund	25.0%	-18.3%	83.9%	13.6%	6.0%	-41.8%	8.3%	-0.5%
Vanguard Smallcap US Index Fund	19.6%	-24.2%	87.5%	15.6%	1.2%	-36.1%	7.3%	1.2%
Vanguard International Index Fund (EAFE)	25.3%	-45.9%	95.9%	26.6%	15.5%	-44.1%	10.8%	-1.4%
Vanguard Emerging Markets Index Fund	61.6%	-29.5%	162.7%	29.4%	39.0%	-52.9%	34.2%	-3.0%
Vanguard Real Estate Investment Trust Fund	-0.4%	47.5%	98.6%	35.1%	-16.5%	-37.2%	-11.7%	-3.0%
BONDS								
Vanguard Short-term Bond Index Fund	2.1%	25.8%	6.5%	4.1%	7.2%	5.4%	1.9%	0.1%
Vanguard Short-term Tax-Ex. Bond Fund	2.6%	13.8%	4.5%	3.2%	4.2%	3.7%	1.7%	0.2%
Vanguard Total Bond Market Index Fund	-0.8%	30.4%	11.1%	4.2%	6.9%	5.1%	2.1%	0.6%
Vanguard Interm-term Tax- Ex. Bond Fund	-2.9%	23.7%	10.3%	4.4%	3.4%	-0.1%	4.8%	-1.0%
Vanguard High-Yield Bond Fund	NA	1.7%	30.7%	8.2%	2.0%	-21.3%	19.8%	2.1%
Vanguard High-Yield Tax-exempt Bond Fund	-3.4%	25.2%	16.5%	5.5%	1.6%	-10.5%	10.8%	-0.8%
Vanguard Inflation-Protected Bond Fund	NA	25.5%	20.0%	0.4%	11.6%	-2.9%	5.5%	0.4%

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

STOCK index prices for US and International indexes posted mixed results during June, ranging from a gain of 3.9% (NASDAQ) to a decline of (3.0%) (Emerging Markets), with the S&P 500 and Dow Industrials basically flat. YTD figures range from a still negative -3.8% for the Dow to +16.4 % for NASDAQ and +34.2% for Emerging Markets. Growth continued to outperform Value, and the REIT sector continued to lag. In general, stock sectors have shown major variations for the year to date; witness the huge 38% spread between the Dow and Emerging Markets.

BOND returns (price change plus interest) for high credit quality corporate bonds and low credit quality high yield (or "junk") bonds continued their gains in June, and YTD. The major gains in government bonds that dominated last year's results, when credit risk was the main focus, have not continued during 2009. Instead, bond investors have been willing to take on additional risk to obtain much higher yields in both high and low credit quality bond markets, as compared to continuing low US government interest rates. Short-term US Treasury yields remain at almost zero, as the Federal Reserve has kept its short-term rates at that level. During September-November 2008, credit quality issues were the key to bond pricing, but from December 2008 through June, the more normal relationship of interest rates and bond prices has returned.

ECONOMIC NEWS reflected some modest positives, in home sales activity, retail sales, and production. However, the June employment report showed continuing job losses well above expectations, and employment levels are the key to much economic activity. "Job losses accelerated more quickly than expected last month, …casting doubt on prospects for the US economy to soon rebound" (WSJ, 7/3-5/09, front page.) Even with the ongoing negative economic news, the key issue of the recession's future duration and severity continues to depend on the success of governments' efforts at economic stimulus and restoring the banking system to some degree of normalcy.

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-June 2009 rally has now reduced those declines to approximately 40% (see chart on page 5). From 2000 through June 2009, the Dow Industrials are now 28% lower, the S&P 500 40% lower, and the NASDAQ a stunning 64% lower, even as NASDAQ is the outperformer in the current stock rally. 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 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 4.9% to 6.3%. 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.

	S&P 500 (1)		DOW (1)		NASDAQ (1)	
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)%
June 30, 2009	919	(40)%	8,447	(28)%	1,835	(64)%

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

	S&P 500 (1)	DOW (1)	NASDAQ (1)
End 1994	459	3,834	752
End 1999	1,470	11,500	4,070
Gain	1,011	7,666	3,318
Avg. Ann. % Gain:'95-'99; 5 years	26.2%	24.6%	40.2%
June 2009	919	8,447	1,835
Gain	460	4,613	1,083
Avg. Ann. % Gain:'95-6/09; 14.5 yrs.	4.9%	5.6%	6.3%

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

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, turned out to be a mild prelude to the declines of Sep.-Nov. 2008, and Jan.-Mar. 9, 2009.

	S&P 500	Change from YE06	Dow Jones Industrials	Change from YE06	NASDAQ	Change from YE06
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 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%
6/30/09	919	-35.2%	8,447	-32.2%	1,835	-24.0%

* 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%. The March-June 2009 recovery from the March 9th lows has been best of all, with gains ranging from 30% to 40%. These recoveries illustrate the dangers of exiting the stock market after periods of substantial declines on the assumption they will continue, and also about using periods of gain as entry points. During this bear market, and with the benefit of hindsight, no rally (until the current one, at least so far) 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.

Before addressing this month's main topic, we would like to repeat the following paragraph from the first page our May Comments, as it is still highly pertinent:

The rapid, significant increase in stock prices since the March 9th lows (S&P500 up 35%) presents the question of whether investors should: (1) sell some stock positions to take some of the recent gains; (2) buy more stock positions, since prices have been rising; or (3) retain their stock positions, based on previously established allocations (and the fact that the S&P 500 is still down approximately 40% from the highs of October 2007). The answer to this question is likely to depend on: (A) your view of the likelihood of an economic recovery in a reasonable time frame, without harmful inflation; and (B) whether you want to act as a short-term investor, focusing on short-term price swings, or as a long-term investor, having established goals for your money and needing some growth potential to meet those goals. 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, well diversified investment portfolio is the best approach, rather than trying to outguess the market's moves.

INVESTMENT CONCEPTS: RISK

This month's discussion of risk will focus on the writings of Peter Bernstein, in his excellent book, "Against the Gods, The Remarkable Story of Risk." We have discussed this book in previous Comments some years ago, and as you will see from the quoted excerpts, his views are just as pertinent today. Mr. Bernstein died last month, and his obituary, by Jason Zweig, who writes the weekly "The Intelligent Investor" column in the WSJ weekend edition, begins: "Investing has yielded a few stars so famous they are known by first name. Warren Buffett is one. Peter L. Bernstein – the economist, investment consultant and prolific author who died on June 5th at 90 –was another (WSJ, 6/13-14, A14.)

Zweig's obituary highlights a few points that pervaded Bernstein's outlook:

""What we like to consider as our wealth has a far more evanescent and transitory character than most of us are ready to admit." He urged investors to regard their gains as a kind of loan that the lender – the financial market – could yank back at any time without any notice."

""We simply do not know what the future holds." Over the ensuing decades (since the 1970s) he returned again and again to that phrase in his speeches, articles, and books, because he felt it captured the central truth about investing."

The remainder of this section consists of quotes from "Against the Gods:"

"The revolutionary idea that defines the boundary between modern times and the past is the mastery of risk: the notion that the future is more than a whim of the gods and that men and women are not passive before nature…. The ability to define what may happen in the future and to choose among alternatives lies at the heart of contemporary societies" (pages 1-2).

"There is a tension between those who assert that the best decisions are based on numbers and quantification, determined by the patterns of the past, and those who base their decisions on more subjective degrees of belief about the uncertain future….The issue boils down to one's view about the extent to which the past determines the future….To what degree should we rely on the patterns of the past to tell us what the future will be like?" (page 6).

"Time is the dominant factor in gambling….Time transforms risk, and the nature of risk is shaped by the time horizon….Once we act, we forfeit the option of waiting until new information comes along. As a result, not acting has a value" (page 15).

"…A decision should involve the strength of our desire for a particular outcome as well as the degree of our belief about the probability of that outcome. The strength of our desire for some thing, which came to be known as utility,... took its place at the center of all theories about decision making and risk taking" (page 71). "The utility resulting from any small increase in wealth will be inversely proportionate to the quantity of goods previously possessed. …The hypothesis that utility is inversely related to the quantity of goods previously possessed is one of the great intellectual leaps in the history of ideas" (page 105).

"Some authorities on stock market behavior insist that stock prices follow a random walk, that they have no memory, and that each observation is independent of the preceding observation….The best way to determine whether changes in stock prices are in fact independent is to find out whether they fall into a normal distribution. Impressive evidence exists to support the case that changes in stock prices are normally distributed….But new information arrives in random fashion. Consequently stock prices move in unpredictable ways….The stock market is a volatile place….Even if the random walk is a valid description of reality in the stock market – even if changes in stock prices fall into a perfect normal distribution – the mean will be something different from zero. The upward bias should come as no surprise. The wealth of owners of common stock has risen over the long run as the economy and revenues and profits of corporations have grown. Since more stock price movements have been up rather than down, the average change in stock prices should work out to more than zero. The year-to-year data suggest that no average of annual stock price changes is typical. The results stretch out in disorderly fashion all over the place around the mean of 7.7% (price change only, not including dividends; including dividends, the mean would be 12.3%). The standard deviation is 19.3%, meaning that two thirds of the time stock prices in any one year are likely to move within a range of +27.0% (which is 7.7% plus 19.3%) and -11.6% (which is 7.7% minus 19.3%)" (pages 145-8).

"As it happens, 33 of the 840 monthly observations (70 years, from January 1926 through December 1995), or about 4% of the total, were more than two standard deviations of the monthly average of +0.6% (to reach the annual 7.7%); two standard deviations would generate a monthly result worse than -11%, or greater than 12.2%. Although 33 superswings are fewer than we might expect in a perfectly random series of observations, 21 of them were on the downside; chance would put that number at 16 or 17….At the extremes the market is not a random walk. At the extremes, the market is more likely to destroy fortunes than to create them. The stock market is a risky place" (pages 149-50). (Our note: Bernstein wrote this in 1996, at the start of the excellent years of 1995-1999, and before the down years of 2000-2002, and the most recent major down year of 2008.)

"What do we mean by normal? When observations wander away from the average of the past, how likely are they to regress to that average in the future? And if they do regress, do they stop at the average or overshoot it? Much risk taking rests on the opportunities that develop from deviations from normal. How do people distinguish between measurable risk and the uncertainty that obliges us to guess what the future will bring" (pages 150-51).

"Regression to the mean (RTM) provides many decision making systems with their philosophical underpinnings….There are few occasions in life when the large are likely to become infinitely large or when the small are likely to become infinitely small….Yet if RTM follows such a constant pattern, why is forecasting such a frustrating activity? There are three reasons why RTM can be such a frustrating guide to decision making. First, it sometimes proceeds at so slow a pace that a shock will disrupt the process. Second, the regression may be so strong that matters do not come to rest once they reach the mean. Rather, they fluctuate around the mean, with repeated, irregular deviations on either side. Finally, the mean itself may be unstable, so that yesterday's normality may be supplanted today by a new one that we know nothing about" (page 172). "Since we never know exactly what is going to happen tomorrow, it is easier to assume that the future will resemble the present than to admit that it may bring some unknown change" (page 173). "But the few who made it big by copping the bets of the crowd receive all the attention. We hear little about those investors who tried the same thing and failed, either because they acted too soon or not at all, or because the mean they expected stock prices to regress to was not the mean to which they actually did regress….In discussing the issue of whether RTM governs the behavior of the stock market, we are really asking whether stock prices are predictable, and under what conditions. No investor can decide what risks to take before answering that question" (page 174).

"We could really say that first the market overreacts to short term news, and then underreacts while awaiting new short term news of a different character…If winners kept on winning and losers kept on losing, our economy would consist of a shrinking handful of giant monopolies and virtually no small companies at all….The track record of professional investment managers are also subject to RTM. There is a strong probability that the hot manager of today will be the cold manager of tomorrow, or at least the day after tomorrow" (page 175). "What about the stock market as a whole?....Price movements in the short run are independent, that is today's price changes tell us nothing about what tomorrow's prices will be. The stock market is unpredictable, a random walk…. But what if returns average out around some kind of long term normal. If so, the stock market may be a risky place for a matter of months or even a couple of years, but the risk of losing anything substantial over a period of five years or longer should be small" (pages 177-8)" After citing some examples of periods in the stock market when RTM did not work, he writes "How much reliance can we place on RTM in judging what the future will bring? What are we to make of a concept that has great power under some conditions but leads to disaster under others….RTM is a tool; not a religion with immutable dogmas and ceremonies" (page 185).

"The essence of risk management lies in maximizing the areas where we have some control over the outcome while minimizing the areas where we have absolutely no control over the outcome and the linkage between effect and cause is hidden from us" (page 197).

"Investors diversify their investments because diversification is their best weapon against variance of return (variance is a statistical measure of how widely the returns on any asset swing around their average….The greater the variance or the standard deviation around the average, the less the average return will signify about what the outcome is likely to be)" (page 252). "Volatility, or variance, has an intuitive appeal as a proxy for risk…but once we introduce the element of time, the linkage between risk and volatility begins to diminish. Time changes risk in many ways, not just in its relation to volatility….The real risk in holding a portfolio is that it might not provide its owner, either during the interim or at some terminal date or both, with the cash required to make essential outlays" (pages 260-1).

The book then moves on to the impact of emotions on investing. "'Decision regret,' is the result of focusing on the assets you might have had if you had made the right decision….It is not limited to the situation in which you sell, and then watch what was sold go through the roof. What about all those investments you never bought, many of which are performing better than the ones you did buy….This has a lot more to do with decisions to diversify than all of Harry Markowitz's most elegant intellectual perorations on the subject - the more investments you own, the greater the chance of holding the big winners. A similar motivation prompts investors to turn their trading over to active portfolio managers, despite evidence that most of them fail to outperform the major market indexes over the long run. The few who do succeed on occasion tend to show little consistency from year to year" (page 285).

"Now we come to the greatest anomaly of all. Even though millions of investors would readily plead guilty to acting in defiance of rationality, the market – where it really counts – acts as though rationality prevailed….'Where it counts' means that there are very few opportunities to profit by betting against irrational investors, even though there is so much evidence of their presence in the market. Where it counts, the market's behavior conforms to the rational model….In the real world, investors seem to have great difficulty outperforming one another in any convincing or consistent fashion….Human investors do turn in outstanding track records from time to time. But even if we ascribe those achievements to skill rather than luck, two problems remain. First, past performance is a frail guide to the future….We have no reliable way of identifying in advance the investors whose skills will win out in the years ahead….The fine performance record of unmanaged index funds is vulnerable to the same kinds of criticism, because the guidance provided by past performance is no more reliable here than it is for active management….Yet a portfolio designed to track one of the major indexes still has clear advantages over actively managed portfolios….lower turnover leads to lower transaction costs and capital gains taxes, and lower fees….These built in advantages are due neither to luck nor are they sensitive to any particular time period. The second problem in relying on evidence of superior management skills is that winning strategies tend to have a brief half life….Many smart people fail to get rich because people not so smart soon follow them and smother the advantage the strategy was designed to create" (pages 296-99).

"Capital markets have always been volatile, because they trade in nothing more than bets on the future, which is full of surprises….Such an environment provides a perfect setting for non-rational behavior; uncertainty is scary. If the non-rational actors overwhelm the rational actors in numbers and in wealth, asset prices are likely to depart from equilibrium levels and to remain there for extended periods of time. Those periods are often long enough to exhaust the patience of the most rational of investors" (page 300).

The book then discusses the use of derivatives as a method of trying to manage risk, but which have also led to many problems (pages 304-328).

The concluding points in the book are as follows (pages 334-337):

"The past seldom obliges by revealing to us when wildness will break out in the future. Wars, depressions, stock market booms and crashes, ethnic massacres come and go, but they always seem to arrive as a surprise. After the fact, when we study the history of what happened, the source of the wildness appears so obvious that we have a hard time understanding how people on the scene missed them. Surprise is endemic above all in the world of finance."

"We cannot enter data about the future into the computer because such data are inaccessible to us. So we pour in data from the past….but past data constitute a sequence of events rather than a set of independent observations….History provides us with only one sample of the economy and the capital markets, not with thousands of separate and randomly distributed numbers….It is in the outliers that the wildness lurks….At the same time we must avoid rejecting numbers when they show more promise of accuracy than intuition and hunch….There has been a transformation of the perception of risk from chance of loss into opportunity for gain, from fate and original design to sophisticated probability-based forecast of the future, and from helplessness to choice."

Our views of all this:

1) Much of what has been quoted here continues applicable to this day, as we would expect.

2) There is no discussion of the market's fluctuations as they relate to the underlying causes at any particular time. The premise is that there will always be something to create problems, and they will be perceived as surprises when they occur (see the first concluding paragraph above). For the moment, key risks include: (1) continuing economic weakness, rising unemployment, and negative economic growth; (2) continuing declines in home prices with increasing foreclosures; (3) a banking system fearful of more losses, reluctant to make loans; and (4) the potential for much higher inflation and interest rates, based on the many government programs to help bring the economy back to reasonable growth.

3) Another major question is where will the new economic growth come from, given declines in industry, and now general consumer spending? Will new technologies in alternative energy, health care, and/or the environment lead the way to new growth?

How will all these problems be resolved, and in what time frame? Since, as Bernstein says, the future is uncertain, should you rely on the past as an indicator of the future? How you address your investing in the context of this uncertainty is what we are here to help you with.

Nick Levinson

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