



Volume 3, Issue 1

# The (not so) Almighty Dollar

January 16, 2009

Monthly Newsletter and Update

Dear Valued Clients, Professionals and Friends,

The year started out with some nice stock market movement which has hit a short term bump in the last few days. I have some clients who are optimistic for the first time in months and some who have suggested we should do some serious selling for the first time.

It is an article of faith with many investors that the stock market is driven by fear or greed and sometimes both. I was once told that someone hoping to become a trader in commodities would be better served to understand what Freud says about mob psychology than to focus overly much on crop forecasts and weather reports.

As mentioned more times than is healthy in this space, I felt something of a crisis in confidence in the fourth quarter as the methods I had installed in the wake of the 2000-2002 stock drop did not do me much good in reducing stock market exposure for myself and my clients. After revamping some of my techniques and spending an inordinate amount of time trying to understand what happened and why I didn't see it coming I have restored a certain amount of confidence about the future.

Despite the "off the chart" loss in the fourth quarter and the damage to the balance sheets of my clients, a review of most of their financial plans has shown that it is possible that their long term plans have not been irrevocably damaged. None of my clients had money in the market that was expected to be needed within the next three years. Even if my short term timing tools don't work, at this moment, it appears that the long term tools did.

Sincerely,

Jeff Sprowles, CFP®



## Early-Quarter Update

- S&P 500 – domestic large cap
  - 12/31 to 1/15 (6.5%)
  - Trailing 1 year (37.4%)
- Lehman Intermediate Gov Bonds
  - 12/31 to 1/15 0.3%
  - Trailing 1 year 9.6%
- 90 Day U.S. Treasury Bills
  - 12/31 to 1/15 0.1%
  - Trailing 1 year 2.1%
- Emerging Markets ETF (EEM)
  - 12/31 to 1/15 (7.9%)
  - Trailing 1 year (50.1%)
- Jeff's Current Stock Outlook  
100% of target

## JEFF'S PICK:

### EWZ — Brazil ETF

Jeff uses this exchange traded fund to invest in 69 companies traded on Brazilian stock exchanges. Despite losing 55% in 2008 its trailing 5 year average annual total return is 18%.

As a country Brazil is almost self-sufficient from an energy point of view and there is an enormous consumer demand. It is probably a bargain at the moment.



Certified Financial Planner

## Market comments

After a brief flurry of up days the market has resumed its gloomy negative trend. My stock target is still 100%. It is possible this is a triumph of wishful thinking over logic but I don't think so.

A negative argument for domestic stocks is that it is difficult to estimate earnings. I have seen price earnings ratios estimates for 2009 ranging from about 10 to 21 for the domestic stock market. The trailing twelve month earnings of the S&P 500 as of 12/31/2008 generated a 10.9 P/E as of year end but I doubt if anybody expects 2008 reported earnings to have a strong relationship to those of 2009.

The positive argument for domestic stocks relates to interest rates and greed. As I write this the dividend (not earnings) yield of the largest five stocks in the S&P 500 Stock Index averages 4.7%. These are not flighty companies — ExxonMobil, Procter & Gamble, General Electric, AT&T and Johnson and Johnson. If an investor, especially an institutional investor, is sitting on a lot of cash — and reportedly many are — they are earning about 1% on money market funds. If they are invested in "safe" Treasury Bills they are earning less than 1%. At some point they are going to ask themselves why they shouldn't be earning 4.7% current return by investing in large, reasonably solid domestic companies instead of money funds. When this happens the bear market will be over.



## FINANCIAL FABLES

Dexter Manly Antwerp retired from his 35 year career at WESAYSO Corporation in 2006. A friend suggested he talk to Jeff Sprowles of Jeff Sprowles and Associates, LLC. Subsequently Dexter Antwerp rolled his 401(k) account and a lump sum pension payment to an account at Charles Schwab Institutional Brokerage and gave Jeff Sprowles and Associates, LLC the power to trade.

Investment results were excellent through the first half of 2008 and Dexter felt satisfied that his assets were in good hands and the financial model he had worked on with Jeff was a reasonable forecast. He believed his lifetime financial plan was likely to be wrong on the conservative side.

The results on his third quarter report were unsettling but following the model, Dexter knew that between three and four years' living expenses were in safe securities and he could afford to ride out the stock market down swing.

During the fourth quarter Dexter became alarmed after reading about investors with Bernie Madoff. He didn't know anybody who had invested in the Madoff hedge fund but the idea that somebody could be receiving statements and then find out that the whole thing was a Ponzi scheme was unsettling. His concerns were amplified when a financial manager closer to home was discovered to have done something similar albeit on a much smaller scale.

Last week Dexter received his fourth quarter report from Jeff Sprowles and Associates. He had been watching his Schwab account balance go down in the monthly statements but seeing the dollar figure lost during 2008 was sickening. He felt a knot in his stomach that was unlike anything he had experienced since he was 8 years old and his pet collie had run into the street and been killed by a 1952 El Dorado.

Dexter had been an engineer at WESAYSO and accustomed to approaching problems objectively and methodically. What should he do? Should he fire Jeff? Should he tell Jeff to sell all of his stocks? Should he get a collie? Should he buy a Cadillac?



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**SOLUTION:** Dexter was due for an update to his financial model with Jeff. At their meeting he discussed his concerns. When they parted company Dexter felt much better and he was positive that he didn't need to buy a collie or a Cadillac. Here is what they reviewed.

1. Bernie Madoff and Ponzi schemes
  - a. Jeff is not Bernie Madoff; he isn't that smart. His background is in fiduciary services, not brokerage. Jeff leads a relatively frugal life style. If he is embezzling from anybody the fruits of the embezzlement are not apparent.
  - b. Jeff does not have custody of any client assets. All of Jeff's clients own their assets directly in brokerage accounts or mutual fund accounts. Jeff has access to trade and for most accounts he downloads information daily for tracking purposes. -BUT- Jeff is not authorized to withdraw cash or securities or transfer them to any place other than bank accounts in the client's name.
  - c. Clients receive statements directly from Schwab about holdings and transactions. The quarterly statements Jeff sends have the same totals as those of the Schwab statements (other than accrued interest) but Jeff has no opportunity to fiddle with the Schwab statements in any way.
2. Losses of 2008
  - a. The losses were beyond the range of comfort that Jeff discussed with Dexter when his investment policy was agreed upon.
  - b. Jeff did not "see it coming" despite the matrix involving valuations and interest rates that Jeff had shown Dexter in 2006.
  - c. Jeff's 2008 numbers were actually worse than the benchmark. Jeff's exposure to international in general and emerging markets in particular were hurt by the strengthening of the dollar in the second half of the year. Jeff's exposure to large cap value hurt results early in 2008 during the sub prime melt down.
  - d. Jeff showed Dexter the history of the emerging markets holdings and noted that when they come back it is likely that they will come back strongly.
  - e. Jeff noted that market reductions are not easy to overcome, especially large ones, but that other than using the losses to rebalance for tax and tactical reasons, it was better to ride the stocks back up now that we have ridden them down.
3. Financial outlook
  - a. A thorough reworking of his model made Dexter feel somewhat better about his ongoing financial situation. He is no longer going to spend his evenings wondering if he needs to go back to work or if he has to sell his house or boat. They ran his model using scenarios including several pessimistic ones from an investment point of view. They paid particular attention to Dexter's cash flow for the next few years to make sure that he knew where he was going to get the money for his living expenses.

