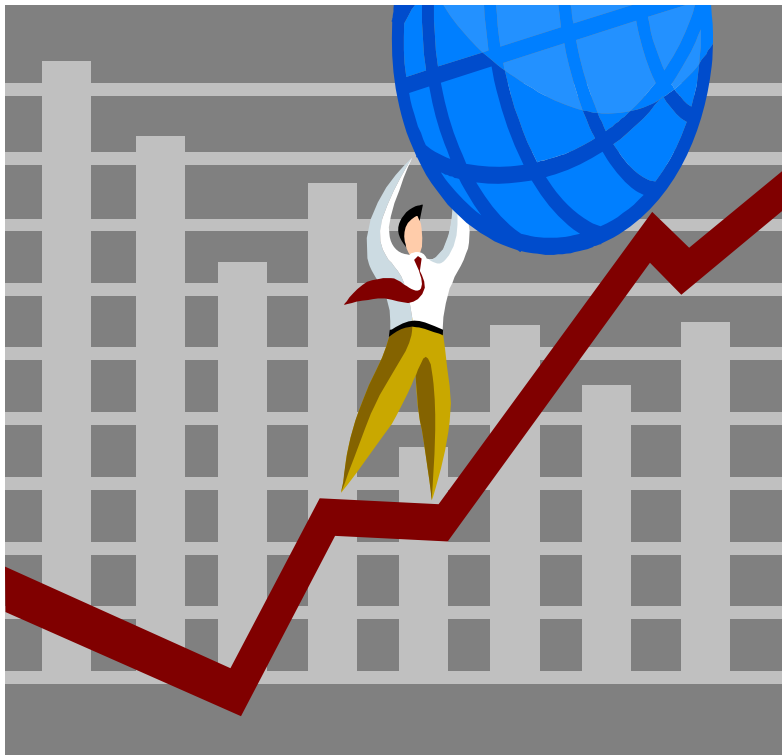


The Promise of the Phoenix Reborn

2008 Q4 Quarterly Commentary



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The Promise of the Phoenix Reborn

Capitalism ebbs and flows like no other system. Right now it is ebbing in a manner that only Sisyphus or Job could describe as moderate. But as we know from past economic cycles: it is precisely from great failures in the economy that we learn the greatest economic lessons. The lessons learned from the Great Depression allowed prosperity to reign for a quarter century (plus those lessons are helping us avoid a similar systemic shock today). Similarly, after the deleveraging of the harsh bear market of 1973-1974, prosperity again reigned for another quarter century. As we move forward we will undoubtedly learn and apply lessons from this cycle that will strengthen and lengthen the next business cycle.

Looking back, it certainly would have been better had:

- Rating agencies not rated subprime and Alt-A mortgages as AAA paper;
- Wall Street investment houses not gotten drunk selling the paper;
- Institutional investors been a bit more mindful of the phrase "Caveat Emptor";
- Individuals been a bit more parsimonious and not so maniacally intent on flipping houses for gain; and
- Regulators and legislators in Washington not been so asleep at the wheel.

But maybe that's expecting a bit too much from the human spirit in the short-term.

Anyway, here we are in early 2009, having gone through an enormous liquidity black hole: \$20 trillion dollars of wealth has evaporated into the aether. Stocks are down nearly 50%. Commodities are down 65%. Corporate bonds, municipal bonds, high-yield bonds and securitized bank loans have all been crushed.

Fortunately, we can say that we are still standing. We are survivors. But like soldiers after battle, there is no feeling of celebration – just a queasy feeling of relief.

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Stocks have been beaten down so much that they should rise even if things are dire. For example, the worst fifteen-year period in U.S. stock market history was the period between 1929 and 1943, when stocks returned a total of just 10%. As stocks have lost about 37% of their value (including dividends) since their high in 2000, stocks would actually have to gain about 10% per year from 2009 to 2014 just to equal the return of the period 1929-1943. But we're more optimistic.

Frank and I have spoken about how the markets create value in a stair step: two steps forward, one step backward. No doubt this is related to investors' fear and greed and the impact they have on making markets under- and over-valued.

We see that stair step in history: The 1920s were a time of huge stock market gains, followed by a poor period in the Great Depression and the beginning of World War II. Following that period, stocks began a tremendous quarter century of positive returns when \$1 invested in stocks became \$16 (after inflation). From 1966 through 1974, markets again performed very poorly. Then from 1975 through 1999, stocks enjoyed yet another quarter century of positive returns when \$1 invested in stocks again grew to \$16 (after inflation). Since 2000, stocks have once again performed poorly. It's important to realize that the laws of economics and markets have not been repealed, and stocks now are trading at much more favorable valuations. The question again is, when does the next cycle begin? The answer is probably when only a relative few believe in increasing wealth

through investing in capital markets. Like in the 1970s, another Business Week cover story entitled "The Death of Equities" couldn't hurt!

The lesson here, of course, is investing never "looked" as good as it did in 1929, 1965 and 1999. But subsequent investment results were never worse. What we, as capitalists, must understand is that investing is never as important to our country or to the world or as valuable to our wealth as when the view in the rear-view mirror is as frightful as it was in 1942, 1975 and, hopefully, 2009.

It was the German economist Werner Sombart (not Joseph Schumpeter, for the investing works out there) who first described the concept of creative destruction. He stated that "from destruction a new spirit of creation arises." Like our Grandparents we have witnessed the destruction of an economic era. But with the dynamism of capitalism and the hard work of its people we can be optimistic that a new era of creation will emerge.

I'd like to share a story that a client, who is a banker, told me a few weeks back. He said that unbeknownst to his Granddad, his Grandma invested a few dollars a week into stocks during the Great Depression with the help of an honest broker. When she died in the early 1960s, his Father and his Granddad were at the reading of her will at their attorney's office. The attorney was going down the list of her possessions and finally came to her brokerage account. Neither his Dad nor his Granddad knew of her investing and were a bit more than surprised when the attorney advised them that the brokerage account held over one million dollars. That amount is conservatively the equivalent of about five million dollars today.

Clearly, when few others did, Grandma believed in capitalism, in creative destruction, and in the promise of the phoenix reborn. She's my hero.

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Our objective in this difficult period is to continue to focus on capital preservation until the new era begins. We believe our focus on corporate bonds will benefit us with positive returns this year while we wait for equities to find their animal spirits. And although we may lessen our exposure to equities a little more, we do want to keep at least a toe in the equity pond because, historically, when equities rally off the bottom, the rally tends to be pretty bold. In addition, we likely will be adding to our gold position as we believe gold may be ready to rally strongly like in 1980 as expectations grow of a resurgence of inflation due to the huge amount of stimulus being injected into the global economy: too many dollars chasing too few goods.

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Believe it or not, there actually has been one very bright spot for me in the midst of all of the negative events of the past several months: the Weyland clients. I have received many kind words of encouragement in response to my periodic e-mail blasts and enjoyed many thought-provoking conversations. We have unexpectedly received wine, homemade fruit bread and even frozen pizza from clients old and new during these trying times. We have also received some referrals of friends and family members – the greatest compliment of all. Thank you all very much for the trust you place in us.

Bob Henkel
Chief Investment Officer

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