

The Advantage Advisor

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Market Commentary:

Hopes that the market bottom which was put in place in November of 2008 were dashed as the Dow pushed below that level in Mid-February, followed shortly thereafter by the S&P-500 Index. It would appear that the broad market has much less faith in the Obama administrations' ability to jump start the economy than originally thought. Unfortunately, president Obama himself has not been a great help as he fostered public fears in order to push through his wide ranging agenda as quickly as possible.

The end result is that since inauguration day, the S&P-500 has fallen nearly 20%. I cannot lay blame solely at the feet of the Obama administration, but I will say that they have done a very poor job of letting the markets know their intentions. If there is one thing the financial markets fear most, it is ambiguity on the part of a very activist government. Because the market has no idea what to expect next, many participants have chosen to just step aside and wait. That lack of buyers is what has allowed the recent wave of selling to take place, pushing the markets down to levels not seen since 1996.

This is clearly a fear-driven market, and that recent wave of selling pushed us once again to very defensive positions within each of our own investment strategies. Our current strategy allocations can be seen on the back page of this newsletter. As you can see by the sizeable amount of green in those charts, we have reduced our market exposure dramatically.

Probably the most frustrating aspect of this market is the fact that stocks and bonds alike (with the exception of Treasury Bonds) are trading at some of the cheapest relative value levels of the last 20 years. What that means is that the fundamentals are there for a strong rally, but the emotional makeup of investors is just has not allowed for it as yet. Over the history of the financial markets, fundamentals have always won the day in the end. For the moment, fear is the driving

<u>Market Index</u>	<u>Closing Price</u>	<u>% Change</u>
Dow Jones Industrial Average	7,063	-11.7%
S&P-500 Stock Index	735	-11.0%
Russell 2000 Stock Index	389	-12.3%
Shearson Treasury Bond Index	17,196	-0.8%
Dow Jones World Stock Index	141	-10.2%
Nasdaq Composite Index	1,378	-6.7%

force, but that will eventually give way and the markets will recover.

The table below is one that I had presented last October, which shows to total return for the S&P-500 from the bottom of each major bear market up to 12/31/2007. What I want to remind you of is this: at the bottom of each of those bear markets was a time of fear and panic that prices would never ever recover to their old highs. And yet, they did so on average in just over four years.

<u>Year</u>	<u>Total</u>	<u>Annualized</u>
2002	89.0%	13.0%
1990	396.9%	9.8%
1987	553.1%	9.7%
1982	1,261.1%	10.6%
1974	2,264.4%	9.6%

It is, without question, difficult to hang in there when so much negativity exists. The tendency is to think that this time must be different - but let me assure you that is exactly the same thing that was said in each of these previous bear markets (as well as at the top of the bull markets!).

Just as in the past, our economy will recover, and the financial markets along with it. It definitely will look different from beforehand, but that can be a good thing as well. Businesses will emerge leaner and more productive than when this downturn started, and that will give them the opportunity to be even more profitable than before.

The Economic Picture

As was widely expected, economic conditions in the 4th quarter of 2008 were very poor. What was not expected was just how bad they really were. The revision to the 4th quarter GDP report was expected to drop to around a -5% to -5.5% level. Yet the report blasted us with a -6.3% drop! Other numbers have been rolling in which confirm that we are in the midst of a very bad recession, likely the worst and longest since the time of the depression. I cringe to make that kind of comparison because our present situation is nowhere near the same depth experienced then. To quote Fed chairman Ben Bernanke, who is an expert on the depression, "...we are an order of magnitude away" from those levels.

Still, the overshadowing negativity of the most recent reports points to a continuation of recessionary conditions throughout most of 2009. The current Fed forecast is for a trough early in the second half of 2009 with growth finally resuming in early 2010. I would have to say that the recent reports certainly back up that forecast, and that is one of the main reasons we have pulled back to very defensive positions within our strategies.

Yet even with all of the doom and gloom, we

Current Economic Position: Stage 6 - Recession

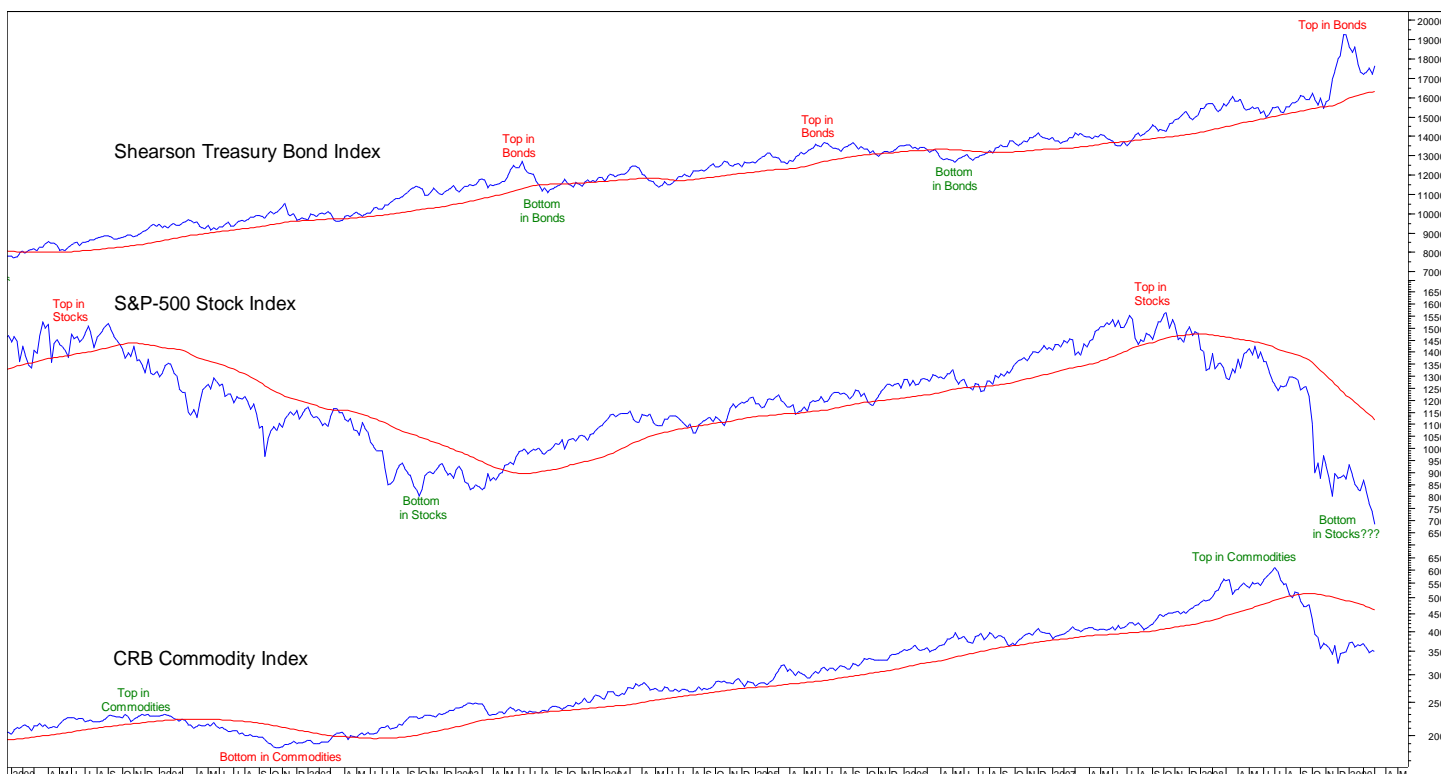
Economic Indicators

	Latest	Prior
Growth		
GDP	- 6.3%↓	- 0.5%
Productivity	- 0.4%	+2.2%↑
Employment Cost Index	+0.5%	+0.7%
Capacity Utilization	72.0%	73.3%↓
Inflation		
Consumer Price Index	+0.3%	- 0.8%↓
PCE Deflator (Personal Inc)	+0.2%	- 0.5%
Implicit Price Deflator (GDP)	+0.5%↑	+3.9%
Sentiment		
Consumer Confidence Index	25.0	37.4↓
Unemployment Rate	+8.1%	+7.6%
Personal Income	+0.4%	- 0.2%

↑=revised up, ↓=revised down

Source: Moody's Economy.com

need to keep in mind a couple of things. First, we have yet to really feel the results of any of the economic stimulus, and there is an awful lot out there waiting to take hold. Second, while things are grim here in the US, it is far worse in the rest of the world. That is not meant to be a "misery loves company" kind of statement. Rather it is a reminder that we have taken major steps forward in making sure that it will be the US that leads the way out of this global recession. Therefore, we should be the first beneficiaries of the upcoming economic recovery.



Source for data: Investor's FastTrack

Long-Term Returns Show The Value of Active Investment Management

Bear markets are tough enough - let alone the worst one since the Great Depression itself! After all, the S&P-500 is now trading at levels not seen for more than a decade. So what does that mean for people who have put money into the markets in just the last several years? For our clients, there is good reason for optimism.

The table below shows the total returns for individual clients of Advantage Investing from either 12/31/2001 or from their inception point through 2/28/09. These are not all of our clients accounts, but I picked a variety that would depict a broad range of portfolio styles. Some of these clients are more aggressive, and some are very conservative. But they all have one thing in common - in every case their investment portfolios have outperformed the broad market by a substantial margin!

In fact, while the S&P-500 has posted a loss in every single timeframe, only those accounts invested since 2003 are showing a loss in value. And yet even though they are showing a loss, they have still dramatically outperformed the broad market. It is never enjoyable to lose money in your investments. But thanks to our active investment management techniques, all of these clients have outperformed the market, and all who have been with us since before 2004 are still in the black. In fact, on an annualized basis, the average excess return for the first four clients in this table is 5.9%!

It is also worth

noting that the starting date of 12/31/2001 was about the middle point of the last major bear market, right after the collapse of the dot-com bubble. Therefore those accounts should provide a good idea of how our techniques perform through a wide variety of conditions. I might also point out that the last account on the list began with us on 7/17/07, just 1% from the all-time high for the S&P-500 index. In retrospect that was a terrible bit of timing, yet even so that client has experienced a loss of less than half what the broad market has produced.

Our goal is to protect your portfolio through these down times, and to capitalize on the positive moves in the uptimes. The net result is that each of our clients should significantly outperform the market benchmark by a significant amount - and as you can see that is exactly what we have done.

I share this with you for two reasons. First, to provide reassurance for our present clients that their trust in our services is well placed. And second, to ask that if you should know of anyone who has not experienced this level of performance in their investment accounts, please let them know of our services. As you may know we do not do any outside advertising and

rely solely on referrals from our present clients to grow our business. Because of that, many people simply don't know that we exist or just what we might do for them.

As always, I want to thank each of our clients for your continued trust in our investment management services. I look forward to a long and rewarding relationship with each of you.

Advantage Investing - Historical Client Returns For The Period Ending 2/28/2009

<u>Portfolio Start Date</u>	<u>Portfolio Total Return*</u>	<u>S&P-500 Index Return</u>	<u>Portfolio Excess Return</u>	<u>Annualized Excess Return</u>
12/31/2001	14.91%	-36.68%	51.59%	5.98%
12/31/2001	14.94%	-36.68%	51.62%	5.98%
12/31/2001	16.93%	-36.68%	53.61%	6.17%
12/31/2001	8.58%	-36.68%	45.26%	5.35%
2/5/2002	23.58%	-32.83%	56.41%	6.52%
2/14/2002	21.43%	-34.27%	55.70%	6.53%
4/22/2002	1.23%	-34.66%	35.89%	4.59%
10/29/2002	32.62%	-17.42%	50.04%	6.62%
5/15/2003	2.97%	-21.73%	24.70%	3.91%
5/24/2004	-12.66%	-32.78%	20.12%	3.93%
7/20/2006	-27.00%	-41.65%	14.65%	5.43%
7/17/2007	-23.20%	-52.56%	29.36%	17.66%

* Total returns represent the cumulative performance of a portfolio over the timeframe shown, inclusive of all fees and expenses. Portfolio composition varies among client accounts, and actual portfolio performance will vary as well. Past performance cannot guarantee future results.

Is Gold Really The Perfect Investment?

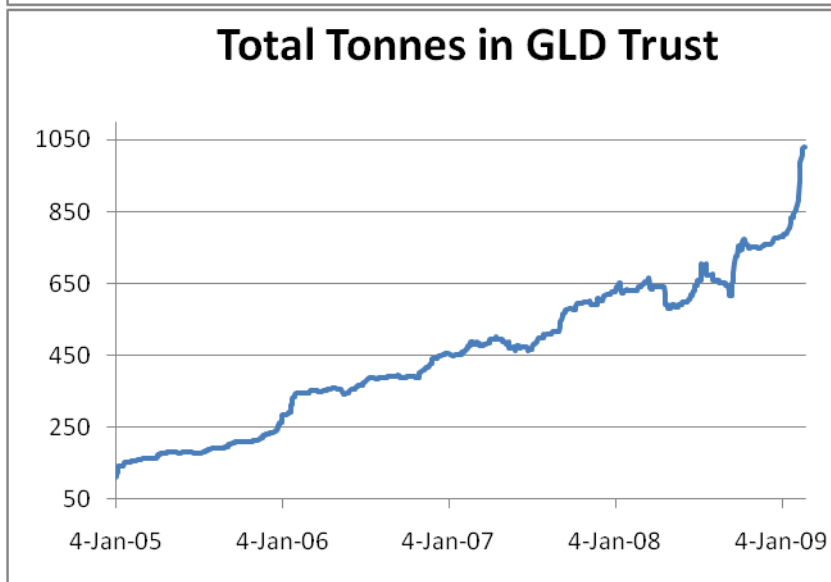
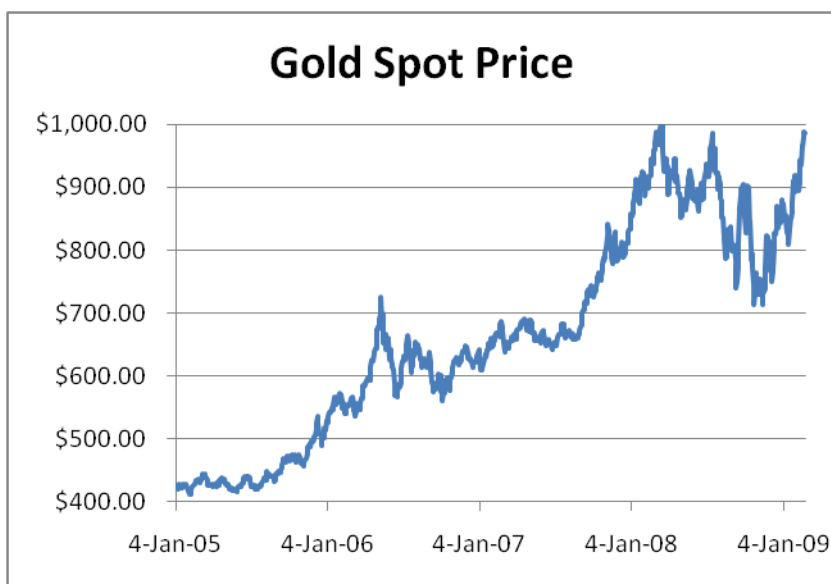
There is no lack of talk about gold right now. You need not listen to the radio for more than just a few minutes before hearing an advertisement to buy gold. There are many experts and others (some of whom I really respect) that are recommending at least some allocation to gold. And yet, just because something seems like a good deal, doesn't mean that is always the case. Consider the following analysis:

Since gold hit its last price peak, back in March of 2008, it has failed to surpass that level, at first falling to a low of \$712 per ounce for a loss of 29.5% in just seven short months. Since then, the price has stabilized and rallied back up to that \$1,000 level once again, only to fall back to \$900 in a matter of weeks. Of course, we know that the markets are exceptionally volatile right now, and there is no reason to think that the gold markets should be any different. But the real problem is not that the price has moved about so dramatically, it is actually one of supply and demand.

To the right there are two charts. The top chart shows the price of gold as it has traded over the past several years. The bottom chart shows the actual holdings of gold bullion (measured in tonnes) as reported by the largest gold ETF, the SPDR Gold Trust (GLD). As investors buy shares in an ETF, the fund is required to purchase matching amounts of the underlying asset - in this case gold bullion.

As you can see, the demand for gold, as represented by the holdings of GLD, has been steadily climbing and shot up dramatically over the past year. Yet, in spite of that rise in demand, the price of gold has not risen concurrently. In fact, the total holdings of GLD increased more than 55% over the past year while the price of gold has actually fallen by almost 10%.

What does this have to do with supply and demand? Simply this, the bottom chart shows a dramatic rise in the demand for gold. Any time there is a short run rise in demand, there should be an accompanying rise in price. The change does not have to be one-for-one, but it should be an increase nonetheless. Yet here, there has been no such price increase. What this tells us is that the market for gold is being driven by speculative forces rather than basic economic forces. Remember when



crude oil hit \$149 per barrel and then came plummeting back to earth? The reason for the rise was massive speculative buying on the part of hedge funds, and the reason for the drop was the sudden panic liquidation of those position by the same.

Now, there is one crucial difference between gold and oil. Crude oil is consumed while gold generally is not. Therefore, this massive increase in the supply of gold is not going to get used up over time. Once the liquidation begins, the price could easily plummet back to the levels we saw several years ago - resulting in substantial losses.

While gold may be a solid long-term investment, like any other commodity there is a time when it is cheap and there is a time when it is overpriced. Gold may well finally surpass that \$1,000 level once again, but there is mounting evidence that it will be a short term peak before supply and demand forces bring it right back down again. And then, the buying opportunity will be there.

Is the Housing Market Recovery close at Hand?

The recovery of the US housing market is without a doubt critical to our eventual economic recovery. The problem with forecasting that particular market is in determining what a fair value might be compared to where prices are at present. Several months ago I published a study I had done based upon the work of economist Robert Schiller, who is the co-creator of the Case/Schiller housing price index. The Case/Schiller index has become the predominate indicator of the US housing market.

Schiller did several long-term studies of the housing markets and determined that the long run real (net of inflation) rate of increase in housing prices is only 0.4% per year. In order to determine what fair values should be today, I used that 0.4% figure, and added to it the average rate of inflation. The results can be seen in the table shown below.

As you can see, the forecast house price in-

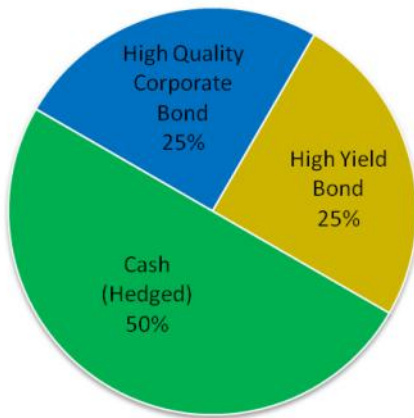
dex level currently stands at 134.29. At present, the level for the National Home Price Index is 139.14, which is just 3.6% higher than the forecast. For comparison, the National Index stood at 164.5 at the end of 2007, almost 27% higher than the forecast index level at that time. Clearly, housing prices nationwide have dropped dramatically over the past year.

The good news is that housing prices nationally are very near their fair value levels, and prices in many major metro areas are well below that level. The tendency for any correction is to overshoot to some degree on the downside, meaning we could see national prices fall by another 7% to 10% before we are through. However, many major areas are already through those levels and may very well begin to show renewed growth starting some time this year. Of course, that assumes that the credit markets and economic conditions are able to support such growth.

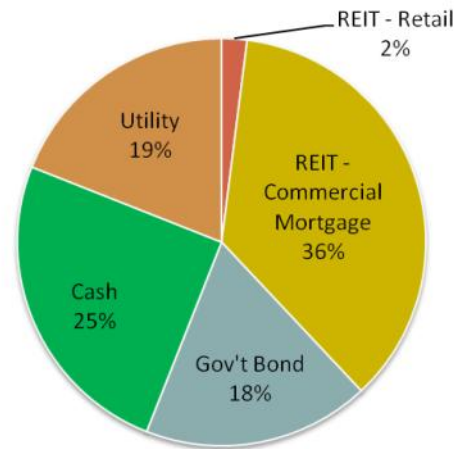
Forecast S&P-Case/Schiller 20 Home Price Index					
(Data as of 12/31/2008)					
<u>Year</u>	<u>Beginning Value</u>	<u>Forecast Increase</u>	<u>Ending Value</u>		
2000	100.00	3.33	103.33		
2001	103.33	3.44	106.77		
2002	106.77	3.56	110.33		
2003	110.33	3.67	114.00		
2004	114.00	3.80	117.80		
2005	117.80	3.92	121.72		
2006	121.72	4.05	125.77		
2007	125.77	4.19	129.96		
2008	129.96	4.33	134.29		
Forecast Long Run Index Level:		134.29	(+3.3% per year)		
Current C/S-20 Index Level:		150.66	(12.2% overvalued)		
Current US National Index Level:		139.14	(3.6% overvalued)		
Under or Fairly Valued Metro Areas:			Most Overvalued Metro Areas:		
<u>Area</u>	<u>Index</u>	<u>% Diff.</u>	<u>Area</u>	<u>Index</u>	<u>% Diff.</u>
Detroit	80.93	-39.7%	New York	183.5	36.6%
Cleveland	105.21	-21.7%	Washington	176.34	31.3%
Dallas	115.63	-13.9%	Los Angeles	171.46	27.7%
Atlanta	113.87	-15.2%	Miami	165.01	22.9%
Charlotte	122.41	-8.8%	Tampa	156.04	16.2%
Denver	125.74	-6.4%	San Diego	152.16	13.3%

Current Investment Management Strategy Allocations

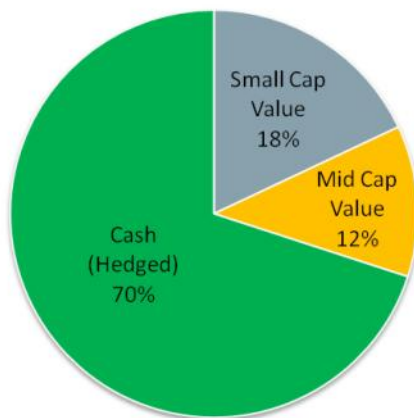
Bond Strategy



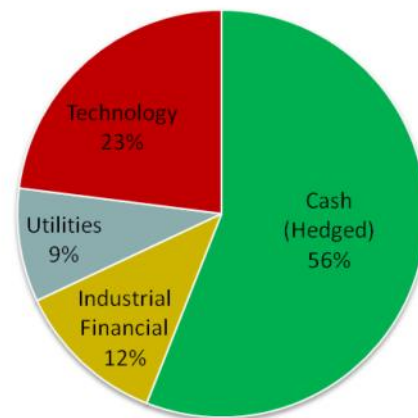
Current Income Strategy



Stock Strategy



Strategic Allocation Strategy



Investment Strategy Update:

Since last month, our investment strategies have moved into much more defensive positions, as can be seen in the charts above. The key reason for this move has been the excessive weakness in virtually all areas of the markets since the presidential inauguration. Clearly, while president Obama may be popular personally, investors are not so enamored by the policies that he is driving through Congress at an historic rate.

All of our strategies are holding much higher than normal levels of cash or cash equivalents. While we want to maintain as much exposure to the markets as

possible, we also want to minimize the downside risks, which is the reason for such defensive positions at the moment.

As was mentioned on page 1, we view this market as very oversold due to fear driving price lower and keeping buyers on the sidelines. Our focus at present is to maintain a defensive posture but be ready to move and take advantage of any interim up turns that may develop. These may be short lived, but they can also be very strong, so we are positioned to move as quickly as possible when they do happen.