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March 8, 2009

INVESTMENT - REVIEW LETTER

I promised a monthly update. The first of the month slipped a little, but with the markets like they are, I am sure you will understand. The markets are very difficult. Let me summarize my thoughts for you, and then you can work thru the details that are outlined below. Note this is a "Review Letter" as compared to an "Investment Advisory" alert.

Summary:
This stock market will continue to sell off for the foreseeable future – probably a month or two at a minimum. It is important to reinvest in the stock market as quickly as it appears clear that the economy is getting some traction. Longer term we will continue to maintain higher levels of fixed income so that we can take advantage of a base cash flow income, expecting an "L" shaped economic recovery for perhaps 2-4 years.

Where we are today:

1. Let me review the current economic trends as I understand them, and then offer some insight as to the future. Understand that what I offer is subject to change as the data changes.
2. It appears that our economic model is fully adjusted to the movement of money supplies and I expect to be able to rely on its forecasting to determine when to reinvest in equities and mutual funds.
3. Near term – for the next several months – I expect the economy to continue to deteriorate: Unemployment will go over 10%; bankruptcies will increase; small business lending has literally dried up; the savings rate has climbed over 5%; commercial paper issued is shrinking, as are commercial and industrial loans.
4. The European banking system is in dire straits, much worse than the U.S. banking system.
5. Don't expect this recession to stabilize. It will become a depression that is much like the 1930's, but with more government support programs so that the pain of its consequences will be softened.
6. 2009 will not be a recovery year.
7. On the brighter side, lots of interesting programs are coming into existence. The Fed, the Treasury, and the FDIC are formulating very creative plans to reinvigorate the financial system. Once the system is preserved, they will move on next to a program that will restart the secondary market system for recycling lending dollars.
8. The Fed is acting like a mega-investment bank, attempting to replace, for the time being, that entire market that has been decimated and vacated by virtually all of the investment banks and private equity groups.
9. The treatment of Citibank last week showed that Mr. Bernacke is a true "Capitalist" in the sense that, by converting some government owned Citibank preferred stock to common stock, in conjunction with an approximate equal amount of privately held preferred stock being converted to common, thus providing a potential for profit in the future, the Fed avoided the nationalization of the bank. This action protected, for now, the ability of the bank to raise more capital in the future thru the preferred stock issuance market.
10. Generally, our portfolios have lower values than they had at the last time I reviewed portfolios (mostly in mid 2008). Since late November, almost all portfolios are up, perhaps as much as 1% to 1.5%, reflecting the move out of equities and their enhanced fixed income investments.

Where do we go from here??

1. I get calls regularly from investors wanting to buy back into the market, asking "is now the time?"
2. The issue, of course, is how to rebuild our portfolios after the losses we suffered in 2008.
3. It is too early to start buying equities again.
4. When the market bottoms and the economy begins to get some traction – meaning that the government rescue plans have begun to accomplish their targeted goals – there will be a reflection of these conditions in our Economic Model. Additionally, there will be technical indicators that will do the same, but with some whipsaw trading action attached to the indicators.
5. The plan is to use the technical indicator recommendations, once the Economic Model confirms that the economy is beginning to grow again.
6. The recommended reinvestment schedule will be a dollar cost average reinvestment process that puts 10% of the planned equity investment to work each week that the Model recommends adding money to equities.
7. In most accounts, the planned reinvestment amount is already separated into a holding place that is currently invested in one or both of the recommended GNMA funds – PIMCO or Vanguard.
8. Generally, we have increased the targeted investment in fixed income by approximately 30%. What this means is that if your targeted fixed income level is 50%, your recommended allocation to fixed income is 65%.
9. It is anticipated that this increased fixed income recommendation will be in force for as long as 1-2 years, dependent upon how well the economic recovery proceeds.
10. In most cases, portfolios are invested in Government guaranteed mortgage backed securities. These securities pay principal and interest every month. As we want to decrease the amount of fixed income back to normal targeted percentages (for example, from 65% back to 50% fixed income), we will use these principal payments to fund the additional move back into equities - instead of reinvesting them into new fixed income investments.

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