

High Desert Investment Advisors

12700 San Rafael NE
Albuquerque NM 87122
505-797-1901

Serving Your Personal Investment Needs Since 2003

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HIGH DESERT ADVISOR - FINANCIAL MODEL ADVISORY

At times when all of those around us are losing their heads, it is the stable and reasoned approach that will bring us home safely.

The turmoil of the last couple of weeks has shown us that the financial markets are in a very precarious position, one that requires constant vigilance and attention by the Treasury and the Federal Reserve Bank. The risk to the financial system is one of cascading failure. I have considerable confidence in our Fed and Treasury managers, Ben Bernacke and Henry Paulson, and believe that they will respond in all ways necessary, in order to control this process of de-leveraging the financial markets. At times there will be fear in the markets. Controlling the de-leveraging process will be difficult and tenuous at times. Clearly, there are sufficient resources in the Fed to handle its obligations now and in the future. Those resources, along with the expertise and experience of Bernacke and Paulson, will make the process orderly.

This is not a time for us to make panic moves in the market. Changes in our portfolios should be done in such a way as to minimize losses, and they should be done over a reasonable time period. Selling when the market goes up is the goal.

It is time, now, to begin moving to a less volatile portfolio design.

The Financial Model is indicating that the economy will slow in the coming months. Thus I recommend that you sell 10% of your equity positions, putting that money into cash. In addition, because of the adjustments we had to make to the Model due to the nature of the Federal Reserve data, I recommend that you do an additional catch-up volatility reduction by selling an additional 5% of your equity positions. Total recommended reduction in equity positions is 15% of the existing positions.

This is a measured reduction of equities. Selling should be done after the market settles down and when we see a decent "up" day if possible. We should try to complete all changes by September 26.

If you followed our July recommendation to change your portfolio, I will presume that you want to make this currently recommended change as well, unless you contact me or Iris and instruct us to the contrary. A reply email to me will suffice, and you can call me, as well. Expect a return confirmation if you instruct us not to sell. Iris can be reached at her office (direct line - 505-880-2705) or by her cell phone (505-220-0571). For those who are new to this process, please contact me with your instructions. I will not make changes without your approval.

Dick Brackett
High Desert Investment Advisors, LLC
Registered Investment Advisor
505-797-2644

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FOOTNOTE:

As a footnote to this advisory, I think that it is appropriate to provide a little more input to you as to how the Financial Model is designed to work and how it predicts the direction of the stock market. The Model will predict underlying economic conditions and forecast their direction. It assumes that the economy is a function of the growth of the Monetary Aggregates, and it relies on data provided by the St. Louis Federal Reserve Bank. When the Aggregates are shrinking, the economy will slow. When the Aggregates are increasing, the economy will grow. Typically, there is about a three month lead time before you see the economic numbers follow the Monetary Aggregates.

What you should take from this description of the Financial Model is that once the current panic selling settles out, the markets will once again follow the trend of the economy. Whenever the stock markets are volatile, after a period of time, they move back to the long term economic growth trend line. This was the case in 1987; it was the case after 911; it was the case in the years 2000 -2002. What we are recommending you do is change your portfolio based upon a long term trend in the economy. This is a measured change and not one that is brought about by what is happening to the stock markets.

Hopefully, this afterthought will give you a more considered view of how the Financial Model generates its recommendations. If you have questions, please call me.