



BOYER & CORPORON
WEALTH MANAGEMENT, LLC

Investment Commentary
January 1, 2009

Happy New Year!! Most of you are probably glad to put 2008 behind you....and for good reasons. From a financial standpoint, 2008 was clearly the most volatile, tumultuous, uncertain and painful calendar year in my adult life (I have been able to vote for 36 years). Surely 2009 cannot be any worse, can it? Surely 2009 HAS to be better than 2008. Doesn't it?

Although we hope 2009 will be better, we are aware of conditions and reasons that could make it as bad or worse. We can think of several reasons WHY we should continue to be very concerned about ALL the securities markets (not just the stock markets).

There is historical precedent that 2009 could be as bad as 2008. In 2008, the Dow Jones Industrial Average declined 33.83%. According to the Wall Street Journal, that ranks as the third worst annual return in the history of the U.S stock market. The two years which rank ahead of 2008 are 1907 and 1931. However, the article continued to list the next 7 worst years and it is chilling to note that included on the list are 1930 and 1932. That means 3 of the worst ten years EVER were the CONSECUTIVE years of 1930 – 1932! The DJIA declined over 75% during those three years which was the beginning of the Great Depression.

Yes, there was no Federal Reserve banking system and no FDIC insurance back then which helps prevent a run on the banking system today. There was no Social Security or Unemployment Compensation. However, there were also no such thing as Sub-Prime mortgages, Alt-A mortgages and Option Arm mortgages. There were no such things as money market mutual funds (most of which are not insured and many of which came perilously close to a "run on the bank" in September). Credit cards charging double digit rates of interest were not available then. Between credit cards and easy mortgage loans, America has spent the past two decades leveraging beyond what anyone in the 1930's could have dreamed. We are not predicting a Great Depression nor are we predicting another year of significant losses in the stock market. We ARE aware, however, that a stock market rally is not a sure thing just because it suffered big losses in 2008.

In a year where we didn't think the headlines could get any bigger, odder or more spectacular, along came Bernard Madoff, a professional

investment advisor in New York City, who has allegedly been running a rather large Ponzi Scheme for many years. He managed to convince an incredibly significant number of sophisticated (and unsophisticated) investors to give him their money to invest and apparently there is not very much money left. There are reported estimates of up to \$50 billion missing.

It is thought that he has been doing this for many years, taking money from new investors and using it to pay older existing investors, making it appear that he is managing money very successfully. This strategy can continue for many years as long as one is able to continue to attract new investors. It comes to an end when markets collapse and redemption requests from investors begin.

We mention this not just because it is an incredible story. We mention it because we would be surprised if Bernard Madoff is the ONLY "investment advisor" or "hedge fund manager" who has been running a Ponzi Scheme. If and when investors start demanding redemptions like they did in 2008, anyone employing a similar strategy will quickly be exposed as they will not have the assets available to meet redemption requests. As long as Madoff is viewed as an isolated incident, markets might remain calm. If, however, a couple more are uncovered, it could cause an avalanche of redemption requests from worried investors (Madoff's list of investors included charities, foundations and university endowments who will act quickly to protect their respective institutions). Such an event would result in stock market activity similar to the stock market of 2008.

In 2008 a record number of hedge funds were forced into liquidation. During the first nine months 693 hedge funds closed their doors, an annual pace of over 900 funds. As we have mentioned previously, most hedge funds do very little in the way of "hedging" and quite a lot in the way of "gambling". Excess returns don't happen regularly without excess risk and a year like 2008 will quickly expose anyone taking excess risk.

If you have been reading our monthly Investment Commentaries, you know that our biggest concern is real estate. There are many issues to be concerned about but the alarming number of mortgage defaults and eventual foreclosures continues to be the most daunting. RealtyTrac reported the following in November:

- In November, 259,085 new foreclosures were filed, an increase of 28% from November, 2007.
- This was a 7% decrease from October, primarily because new state laws and lender programs allowed delinquent borrowers to stay in their homes (temporarily).
- The number of homes reverting to lenders will increase to 1 million in 2009, an increase from about 880,000 this year.

The moratorium on foreclosures will be expiring soon. Initial jobless claims increased to 573,000 in the week ending December 6th, the highest level

since 1982. Property values have declined 13% since one year ago and will likely continue to decline. Bloomberg reports that close to 70% of borrowers with troubled mortgages won't be aided by the new lending programs designed to help them because:

- They are investors and don't qualify.
- They are in default for the second time on the property.
- They can't be found.

If they qualify and are only in default for the 1st time, how are the new lending programs going to deal with a borrower that owes significantly more than the property is worth today? What will motivate the borrower to continue making payments on a \$300,000 mortgage when the house is only worth \$250,000? Honor? Integrity? Those are noble thoughts but they disappear quickly when the borrower loses his/her job.

The Bush administration granted \$17.4 billion to the Big Three automakers, avoiding imminent bankruptcy for GM and Chrysler. We have not heard anything convincing that leads us to believe this will make any of them more efficient, profitable or competitive. As patriotic Americans, we would love to see domestic manufacturers in any industry be the best in the world. In our opinion, bailing out the automakers is not likely to make that happen. It appears that the Bush administration gave them just enough money to survive long enough to become Obama's problem.

Last week the rate on a 30-year mortgage was an average of 5.14% and we heard of 30-year fixed rate mortgages being offered as low as 4.875%. This is the result of the U.S. Treasury's efforts to drive down mortgage rates to help troubled borrowers. The unintended consequence of this is that the borrowers who will likely benefit the most are the credit-worthy homeowners (and all those unemployed mortgage brokers who will now be back at work with an avalanche of re-finance applications).

There is some good news:

U.S. households paid down debt for the first time since the Federal Reserve Central Bank started recording this information in 1952. Although I list this item in the "Good news" section, it's a little disturbing that debt has increased my entire life. Also, paying down debt means the U.S. consumer is not spending very much at a time when consumer spending is probably needed the most.

Oil prices continued to decline in December, giving the consumer a little more discretionary income. The price of a barrel of oil declined from \$54.43 at the end of November to \$44.60 at the end of December.

Obama has promised a stimulus package shortly after his inauguration. Estimated to be at least \$675 billion, rumors are it will focus mainly on infrastructure, tax breaks and aid to states. This should help the economy appear healthier for a short period of time. We would like to think it will have longer lasting effects but we will have to see more details.

Our outlook

It is our opinion that U.S. Treasury yields are low due to foreign investors seeking a safe haven in the dollar and Treasury bonds. As foreign nations need funds to stimulate their own economies, Treasury Bonds will sell off resulting in higher interest rates. The U.S. stock markets (which have rallied over 19% since the low on November 20th) and equity markets around the world will continue to struggle in 2009. As the U.S. struggles with another wave of mortgage defaults and foreclosures, real estate prices will not rebound and may decline further (which perpetuates the problem). Significant numbers of retail bankruptcies and store closings will result in defaults on commercial loans, further straining our banking system. Boyer & Corporon Wealth Management continues to have large allocations to cash and short-term fixed income investments. However, we see opportunities in the municipal bond market and mortgage backed securities (YES, mortgage backed securities). Short-term MBS offered by Government National Mortgage Association have annual yields in excess of 5%. We are also looking for equity opportunities based on demographic trends with companies that pay attractive dividends and have reliable and predictable cash flows.