



Fourth Quarter 2008 Investment Report

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Is It Soup Yet?



Have we bottomed? Is the worst over? Has the bull market started yet? No matter how you say it, many investors are thinking, or at least hoping, that the market will go no lower than it did in mid November. The above chart shows the S&P 500 Index from its high in October 2007 until the end of 2008. We can see that there have been five distinct "bottoms" or new lows, since peaking in late 2007. Notice that some of the bottoms are literally single day events, while others are double or

triple bottoms that take several weeks or months to occur. With each new low, the market has bounced back up, with gains of 10-20% or more, only to come down and make a new low.

The point of this graph is not to bring back miserable memories. Rather, it is to show the difficulty in "calling" market bottoms. We may not know for several more months whether the November 2008 low is in fact **the** bottom or not. If it turns out that November was the low, then chances are, by the time we realize this fact, the market will have already regained a meaningful amount of its losses. And forget about reading the paper or watching TV to get information about when the bottom will occur. Stock markets **always** bottom before the economy does, which means that the news will always be worse after the bottom is already in place. If you wait for good news to occur before getting (back) into the market, the bottom will be long gone.

That is precisely why we advise our clients to stay invested and patient. By the time everyone "knows" the market has bottomed, the market will have already rewarded investors who have stayed the course. By owning portfolios that are well diversified, we will be assured of owning portions of the best performing asset classes in the new bull market, even if we currently do not know exactly which ones they will be. Needless to say, when the soup is finally done, we are all looking forward to a hearty bowlful.

MAD(as hell)OFF

That's the feeling that most of Bernard Madoff's investors are experiencing right now. They put their full trust into this financial icon, only to find out that he was running the grandest of all Ponzi schemes. Here is some advice for those who don't want to end up in similar circumstances:

- Invest in assets that you can see, otherwise known as "transparency". Many hedge funds and other "opaque" vehicles such as private Collective Trusts or Unit Investment Trusts simply don't allow an investor to know exactly what is going on with their money. Madoff's investors are finding out that not seeing what you own can lead to disaster.
- House your assets at a reputable, third party custodian. Madoff's clients kept their assets at Madoff's own securities firm. So Bernard could literally print anything he wanted on "his" brokerage reports.

Dixon Hughes Wealth Advisors has been following the above advice from our first day of business. Our investment vehicles are totally transparent, institutional, pure no-load asset class mutual funds. In addition, we hold all client assets at TD Ameritrade Institutional Services - one of the largest and most reputable institutional custodial firms in the world. Your DHWA advisor never has possession of your assets; we only instruct your custodian when to buy and sell. Only you have access to your funds.

Trust is a great thing. But without the precautions of transparency and independent custody, trust doesn't mean much. Just ask those angry Madoff investors.

Active Management Bites the Dust...Again

Active investment management is defined as buying low and selling high in an attempt to beat your benchmark. Historically, during bull markets, the majority of active managers have under performed their benchmarks. Passive managers simply own a group of securities that replicate a benchmark index, or asset class. Active managers claim one of the reasons for this under performance in good times is that passive management is virtually always fully invested, and don't have much cash in the portfolio to drag down performance. Many active managers claim that they will out perform passive management in bear markets, when their ability to raise cash will help soften the blow. That makes good sense. Unfortunately for them, that reasoning has proved false

According to Morningstar Inc.,* over 70% of the largest 100 actively managed mutual funds underperformed the S&P 500 Index in 2008 through October 28 (date of study). That means that during the worst bear market in recent memory, the majority of the largest active mutual fund managers have done worse than their passive benchmark counterparts. This is true even though the active managers had the ability to raise as much cash or use other hedging techniques if they desired. The moral of this story is that active management finds it difficult to beat passive, even when the odds appear to favor it (like a bear market). Passive management is predictable, more tax efficient and much cheaper....in good times, and bad.

*InvestmentNews "Big mutual funds stumble in market collapse" 11/08

Fourth Quarter 2008 Asset Class Returns

	4th Qtr	'08 YTD
S & P 500	-21.94%	-37.02%
Large Cap Value	-27.86%	-40.80%
Medium Cap	-25.63%	-41.82%
Small Cap	-26.66%	-36.07%
Small Cap Value	-28.70%	-36.79%
Micro Cap	-26.98%	-36.72%
Real Estate	-38.16%	-37.05%
Intermediate Income	6.83%	4.93%
Long Term Income	13.13%	8.73%
Int'l Large Cap	-20.63%	-41.44%
Int'l Large Cap Value	-24.43%	-46.33%
Int'l Small Cap	-21.42%	-43.87%
Int'l Small Cap Value	-19.38%	-41.68%
Int'l Emerging Mkts	-27.82%	-52.81%
Int'l Em. Mkts Value	-28.51%	-53.94%
Int'l Em. Mkts Small	-25.39%	-54.53%
Pacific	-14.19%	-34.36%
European	-21.78%	-44.73%
Int'l Real Estate	-33.03%	-51.92%

Vanguard Group and DFA, Inc.

With all the television and press coverage and your monthly brokerage statements, it is probably needless to say that the fourth quarter had some of the most negative quarterly returns in history. And as the chart at the beginning of this letter shows, this is after a decent bounce from the November lows. The severe fourth quarter only punctuated horrible yearly figures, which showed reductions in equity asset class values from 1/3 to 1/2 and more. Most Domestic and International stock returns were quite similar, which underscored that even with excellent diversification among nations, company size (Large and Small), and company style (Growth and Value), with the panic selling that occurred during October and November, no amount of diversification lessened the blow.

Bonds appeared to have good quarterly and year to date returns, but that was actually a deception. Government bonds posted excellent returns, but all other type of bonds were pounded down, with some of their worst quarterly returns on record. In many cases, investment grade bonds lost 15% to 25% of their value. Municipal bonds were also hammered, often hampered by the fact that many insuring companies (such as MBIA and AMBAC), which municipalities use to establish AAA ratings, were hurt by the mortgage collateralized bond market, and consequently the ratings of huge amounts of municipal debt were decreased - sometimes twice or three times during the quarter. High yield corporate (junk) bonds had equity like losses. Lastly, mortgage-backed bonds, as you may have guessed, had some of the poorest returns of all. So, unless your income vehicles were strictly guaranteed by the US Treasury, most investors' bond returns were meaningfully negative.

Since the third week of November, both stock and bond markets have begun to slowly repair themselves. Most equity asset classes have moved up 15% or more from their lows. As mentioned earlier in this letter, whether this was a bottom, or the bottom, won't be known for a few more months. Regardless, market valuations continue to be at multi-decade lows, which suggests very generous multiyear returns for the patient, long term, investor. After the drubbing the market has taken over the past year, it only makes sense to stay the course and potentially receive the upside rewards that volatile equity markets can produce.

As we say goodbye to all things relating to 2008, it reminds us of a joke. A concerned client asks his advisor how he's holding up under all the tough market conditions. The advisor replies, "No problem, I'm sleeping like a baby -- up every two hours crying and screaming for my mother!"

We hope 2009 will give us all reasons for much better sleep. The New Year is sure to have some exciting times -- hopefully pleasant ones. All of us here at Dixon Hughes Wealth Advisors wish you a very healthy and prosperous New Year.

Sincerely,

Dixon Hughes Wealth Advisors