

BWMInvestment
Guidance**First Quarter Markets Review**
*A Wild Ride**Recession Remains in Full Force***Key Points**

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|---|-------|---|
| • First Quarter 2009 Total Returns : | | |
| S&P 500 (797) | -11% | ; |
| US 10Yr Bond (2.68%) | -11% | ; |
| NASDAQ (1528) | -3% | ; |
| Foreign (EAFE) Stocks | -16% | |
| • U.S. GDP expected contraction = | -2.2% | |
| • 2009 earnings expected decline = | -20% | |
| • Significant 1 st Qtr losses; Markets & economy continue to search for bottom | | |

Executive Overview

Equity markets extended losses in the 1st Qtr. to five consecutive quarters; S&P 500 index -11%, -22%, -9%, -3%, and -10%. That is the longest declining streak since World War II. Foreign EAFE index 1st Qtr. losses (16%) were similar. (Mar. month end prices were higher than Feb. month end levels.) Investor caution and market volatility remain high. The revised 4th Qtr GDP (-6.3%) report verified a deep recession. The prices of gold (4%) and crude oil (4%) rose, and the USD gained (5%) in the 1st Qtr. versus the Euro. Most other asset classes, including homes, suffered big losses. Commodities generally drifted lower. The 10 yr. Treasury bond (-11%) fell. Certain economic indicators remain very weak, such as employment and capacity utilization. Other Leading Economic Indicators are steady at low levels. Huge financial sector write offs, especially AIG, forced 4th 2008 S&P 500 earnings down 62% below 4th Qtr 2007 earnings. Corporate 1st and 2nd Qtr 2009 forecasts are highly uncertain. Earnings are expected to fall over 30% below comparable periods. In the midst of a deep recession, numerous government policy initiatives continue. Domestic and international economy, earnings, and investment portfolio suggestions will also be discussed.

Themes

Investment markets themes are: Financial market policies, auto industry issues, mixed Congressional and Obama administration messages, and the status of the American household.

Priority One: Stabilize the financial sector

The Obama Administration led by Treasury Secretary Geithner is struggling with the same Troubled Assets Relief Program (TARP) issues as Secretary Paulson. What is the best combination of bank recapitalization, buying toxic assets from banks, and loan guarantees to stabilize the money center bank financial balance sheets? It is a difficult problem. After announcing an incomplete plan that drove a February market selloffs, Secretary Geithner developed a Public-Private Investment Program (PPIP) with Federal Deposit Insurance Corporation Chairwomen Bair. The plan is to persuade private groups of hedge funds and private equity groups to buy potentially \$1,000B of primarily derivative illiquid mortgage backed securities (toxic assets) from banks with government financial aid. Other potential partners (pensions and mutual funds) with the government in the PPIP are unlikely, as will be explained.

The program is a complex application of high stakes game theory. The players are the banks, who hold and have the most information on the illiquid derivative assets, the Treasury Dept., which matches the private partner stakes with taxpayer TARP funds and sets the interest rate on the FDIC loan, and the FDIC, which finances the loan. The FDIC potential loan leverage on the Treasury Dept. and private fund equity is stated to be 6:1. Among the many ironies is the large government leverage plan to attempt to correct a problem caused in part by government support of homeowner mortgage leverage and bank derivatives (capital ratio) leverage.

The banks decide what toxic assets to offer. Considering previous write downs, the offer price may represent a potential gain or loss. (Losses are most likely.) The banks will be cautious about offering assets at significant losses, because the transaction must be recognized on their balance sheet, as a likely reduction of capital. On the other hand, there are factors, such as the Treasury Dept. stress tests and mark to market accounting rules, which will influence decisions of the players in these transactions. The Treasury will decide what interest rates that the FDIC will charge. If they are too high, then the private parties may decide that the risks are too high to participate. The FDIC reviews the assets offered and decides how much to finance. The private parties decide to play based on their own sources of information.

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There are many reasons why this Treasury Dept. plan may not generate significant or satisfactory responses. Mr. Geithner has been in contact with the key players in the hedge fund, private equity, bank, and investment banking universe as part of his responsibility as Federal Reserve Bank of New York governor and now Treasury Secretary. Based on his participation in all the financial bailouts to date and related experience, he should be the best person to develop a plan. However, bailout plans involve consensus building. Implementing plans with private parties require leadership. To date Mr. Geithner has not communicated well and not shown good leadership decisions. Yet, the banks and other government related entities will participate.

There are other issues. If the hedge funds have acceptable information and make good forecasts on the cash flow payments of the assets purchased, then based on the leveraged loans and interest rate charged, they may earn two or three times their investment over the life of the cash flows. This is hard to translate into annual real rates of return because of many factors including future inflation. Otherwise, they are effectively buying a call option. They are taking the risk that they will lose their entire investment. The banks have the most information and may conclude that they are better off, if they do not offer the toxic assets at low prices indicated in a near illiquid market. Perhaps, President Obama and Secretary Geithner set the rules of the game in a Mar. 27 meeting with the bankers, who they have most control over. In any case, what about the taxpayer? The PPIP may be unsuccessful because the process of establishing liquidity takes years to work out and the economy may linger along in a stagflation mode. The PPIP may be unsuccessful if both private parties lose their full investment and the government (taxpayers) loses even more based on the leveraging. Trying to encourage fair market value transactions (not over or under economic cash flow values) with super charged leverage is a near impossible task. That is why civilizations typically flourish in truly free markets, where mistakes are quickly corrected on the next transaction. Pension and mutual funds are unlikely players in the PPIP. Most of them know that they don't have enough information to speculate with toxic assets. Even the hedge funds will likely be hesitant to participate after the shameful lynching of AIG bonus recipients by Congress. What will Congress and the Administration do to them if they are successful?

Another approach: Change the Rules.

Two factors may help stabilize markets in very different ways. The financial balance sheets, especially of banks, may be changed by modifying mark to market asset accounting rules. The volatility of markets may be reduced by adjusting transaction "short on uptick" rules.

The accounting rule that defines fair value for an asset that is considered to be held for market transactions requires the asset to reflect similar asset market prices. However, in a deleveraging current environment, the number of potential buyers is reduced and many sales are effectively forced for various technical reasons. Due to the low number of transactions and large spread between offer and asking prices, markets are illiquid for many hard to evaluate derivative assets. The Chamber of Commerce and many banks are pressuring Congressmen to change the accounting rules to allow companies to use "significant judgment" in valuing assets and reduce the amount of writedowns they must take on so called impaired assets, mostly mortgage backed securities. The Financial Accounting Standards Board (FASB) has been under extreme pressure in Congressional hearings to eviscerate the mark to market accounting rule. The FASB and SEC have given various interpretations to the rule. But that has not been good enough for the bankers and Congress. It appears that FASB will relent under pressure and allow "significant judgment" to take into account cash flows of securities. Some estimates are that bank earnings could be boosted on paper 20% in the 1st Qtr. financial statements due in April. My view is that full exposition of the judgment valuation model used and the mark to market valuation should both be required in the statement disclosure notes. This will allow the investors to have all relevant information and the bank controller to use the judgment information to potentially relax capital requirements in an open manner. It is a critical discipline to hold.

The market transactions "short on uptick" rule is an easier rule to reapply. It was instituted by the Securities Exchange Act of 1934 as Rule 10a-1 to slow the process of consecutive sales, sometimes called "bear raids" of stocks by those who borrowed and sold stocks they did not own. The rule responded to the extreme 90% stock index loss between August 1929 and June 1932 under apparent bear raid conditions. In July, 2007 the rule was rescinded after an SEC study determined that market volatility was very low

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over the recent past 3 years and multiple private markets should provide added liquidity to avoid barrages of selling in specific stocks. The timing could not have been worse. During the recent recession extreme market volatility has returned with waves of relentless selling. Programmed trading likely contributed. The SEC Chairwomen recently responded to Congress. Upon completion of specific procedures a variation of the "short on uptick" rule that technically uses offered prices as a basis for short sales will be reinstated in the near term. That should support reduced volatility and more efficient markets.

Is the Federal Reserve Board Very Active? Yes

The FRB senses the American taxpayer is very concerned about the extraordinary expansion in both the assets added to its Balance Sheet and the money supply. Chairman Bernanke gave an informative *60 Minutes* interview. In summary, the Term Asset-Backed Loan Facility was recently expanded to purchase auto, credit card, and other financial assets, funding to Fannie Mae and Freddie Mac was increased to \$1,000B, and a commitment (\$300B) was made to purchase Treasury Securities. The later action informed the markets that when the Treasury Dept. issues bonds to finance massive deficit spending, the FRB will buy (demand) some of those bonds in order to keep a ceiling on yields and related mortgage rates below 5.00%. The technical term is quantitative easing. The practical effect is increasing the money in circulation to a level that will be politically difficult to control, when the economic activity eventually starts improving. The Treasury Dept. and FRB in poker terms have doubled down to both increase credit availability and finance the incredible deficit spending taking place. The entire process is an extremely risky policy that even the intellectual godfather, Lord Keynes, may wonder about.

Secretary Geithner's Regulatory Reform

The Treasury Secretary provided his framework for so called new rules of the road. There are good components to the framework in my view, as well as vague concepts which will cause bad unintended consequences. Let's start with the good ideas. A comprehensive oversight, protection, and disclosure process for derivatives including generally standard contracts and a clearinghouse is proposed. It is needed for transparency and reduced counterparty risk. A new requirement for money market funds to reduce risks and improve liquidity is a good idea for an asset class that is considered by most

people as risk free. A higher standard of risk management for financial firms and requiring hedge funds to register certain data is reasonable. The bad idea is an overseeing regulator, presumably the Treasury Dept., responsible for systemically important firms and systemic risk management. Mr. Geithner has not defined systemic risk, because it means different concepts and involves different principles for various parties. More important, the idea implies control over different government bodies, FRB, SEC, and FDIC, which have specific independent charters. Chairman Bernanke seems to sense trouble and made indirect comments about his responsibilities to focus on price stability by reining in extraordinary credit, when the economy starts to improve. The SEC Chairwoman has also responded. Watch how this regulatory reform process develops. There are ways to unintentionally slow the entire economy through excess regulations. That was part of late 1970's poor government policy.

Government Direction of the Auto Industry

The Obama Administration decided to give General Motors 60 days more and working capital bailout financing for a recovery plan and Chrysler 30 days more and working capital financing to merge with Fiat SpA. President Obama effectively took over General Motors and is running it as Government Motors, regardless of contrary statements. The CEO was dismissed. This gives a clear signal to any executive taking government handouts, that he is serving the President and not his majority shareholders. The new CEO was selected, an interim Chairman of the Board was named, and Directors will be replaced. The U.S. government took over car warranty responsibilities and most of the payments (\$2.5B) through TARP for GM and Chrysler. Think about it. Will the government administer an effective warranty program responsive to customer desires? The most likely outcome is the same prearranged bankruptcy process, which Senator Cocker attempted to broker in Nov. 2008 Senate Finance Committee hearings, at a far higher cost to taxpayers in June, 2009. Additionally, the Obama GM Directors will drag out the bankruptcy and restructuring proceedings. But, look at the positive side. Few corporate heads will beg for government bailouts in the future. The cost is too high!

Mixed Government Messages – Not Good

The President, Treasury Secretary, and Congressional members of both political parties

responded shamefully to the American International Group (AIG) retention bonus payments. AIG made a tactical mistake to offer employees retention bonuses instead of regular salaries to help it transition through liquidation. It should have paid salaries and probably lost some good people in the process. Congress made an error in specifically permitting bonuses for companies receiving TARP funds in the \$400B Omnibus Stimuli Act. The President, Treasury Secretary, and members of Congress were not truthful, when they stated that they did not know about the bonuses. Finally, the House of Representatives ignored Article 1 Sect. 9 of the U.S. Constitution that states no Bill of Attainder or ex post facto law shall be passed to punish a specific group for past actions without the benefit of a trial, when it passed an act to tax employee bonuses of firms receiving TARP funds at a special 90% tax rate. The politicians sent mixed messages to all involved, while playing on the frustration of taxpayers concerning the poor administration of the TARP.

The Administration is approaching a protectionist trade war due to the American Recovery & Reinvestment (Stimulus) Act of 2009 "Buy American" clause and rescinding the NAFTA Mexican long haul truck delivery program. Mexico quickly responded with \$2.4B in tariffs. The President declares that the U.S. supports free trade, but is doing the opposite. The best hope is that U.S. protectionism will be contained. Do not expect any in-process free trade agreement to be enacted by this administration. Expect other nations with U.S. trade agreements to act very quickly to take the U.S. to World Trade Organization conflict arbitration, when the U.S. takes other protectionist measures. This will reduce trade and slow down the U.S. economic recovery.

The American Consumer is value oriented

The U.S. household net worth peaked in the 2nd Qtr. 2007 at \$64.4T and in the 4th Qtr. 2008 fell to \$51.5T. That is a 20% decline, which was impacted by both home (American's prime asset) and financial asset declines. More importantly, total home equity fell to a record low 43%. Home equity loans are no longer a source of consumption spending. The savings rate has been above 4% for 2 months and will likely remain at these normal levels. Consumer spending, which accounts for about 70% of the U.S. economy, will probably not increase more than a few per cent during the next few years,

although refinancing will reduce home mortgage payments and support spending. In summary, savings will dominate, while housing prices bottom out during the next year and remain flat over the following 3 or 4 years. The scenario will limit consumer confidence and form a ceiling on consumer spending.

The Economy – Deep Recession Continues

There are few signs of an economic recovery. The 8.1% unemployment rate will increase in the Apr. 3 (March report) owing to steady added unemployment claims. Consumer spending will likely remain unchanged in the 2nd Qtr. due to the stimulus tax credits. (Remember the 2nd Qtr. 2008 GDP increased due to tax rebates.) However, the manufacturing level, regional output reports, and construction spending remain depressed. Capacity utilization is currently 70.9%; that is 10% below the 1972 to 2008 average level. The most likely scenario is for inventory levels of homes, durable goods, and consumer goods to fall during the next 3 months. First quarter GDP evidently fell about the same (6.3%) as 4th Qtr. GDP; however, 2nd Qtr. GDP will likely fall less (3%) as the unemployment rate continues to rise and this long recession runs its course. Forecasts are spread out. No one has high confidence in their forecasts during this large abnormal credit contraction period.

Profits and Expectations continue to fall

Financial sector losses, especially AIG and money center banks, drove S&P 500 company total 4th Qtr. 2008 earnings down 62% below 4th Qtr. 2007 earnings. S&P 500 company book values decreased a startling 37% and earnings fell 19% in 2008. Analysts continue to cut 2009 and 2010 forecasts. No economic sector 2009 earnings forecasts are above 2008 levels; while the defensive sectors of Consumer Staples (0%), Utilities (-1%) and Healthcare (-2%) appear to be most steady. To paint the picture differently, S&P 500 company earnings are forecast to continue to fall in the 1st Qtr. (37%) and 2nd Qtr. (31%) compared to 2008 quarters.

Financial Analyst forecasts are also falling.

The current analysts' forecast revision ratio is very negative 4:1 downgrades/upgrades in 2009. Analysts have reduced forecast earnings declines in 2009 to \$55 for the weighted S&P 500 shares in the Zacks methodology and to \$35 in the strict Standard & Poors methodology. At this time, the S&P 500 trades at 14 to 23 times 2009 earnings based on your choice of forecasts. Investors

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don't see earnings stability yet and are generally holding cash.

Foreign Economies

Developed economy GDP declines are expected in 2009 after extreme 2008 4th Qtr. declines. Major exporters Japan and Germany are hard hit and uncertain about 2010 GDP growth. The emerging markets 2009 economic forecasts were reduced again last month. U.S., China, Britain, the European Union and various other countries have announced Keynesian demand stimulus plans to push their economies out of recession. Inflation or deflation is not a developed country issue, although Russia, India, and Brazil must control inflation. Key forecasts according to the *Economist* follow.

Table 1. Economic Forecasts

Economic Market	2009 GDP	2010 GDP	2009 CPI
United States	-2.2	1.9	0
Japan	-5.3	0.5	0.2
China	6.0	7.0	0
Great Britain	-3.1	0.5	3.0
Euro Common Mkt ECM	-2.4	0.7	1.2
Russia	-2.0	3.0	12.0
India	5.0	6.6	10.0
Brazil	-0.4	3.2	5.9

The total global economy will likely show 2009 contraction. In Table 2 the U.S. positively sloped yield curve continues to be the most stimulative monetary policy.

Table 2. Current Global Yields

Economic Market	3 month	10 Year
United States	0.4	2.9
Japan	0.6	1.3
China	1.3	3.2
Great Britain	1.9	3.1
Euro Common Mkt ECM	1.7	3.1
Russia	13.0	11.4
India	4.7	7.3
Brazil	11.2	6.2

The S&P 500 rose 8% in March, but I remain cautious. The underlying economy has not responded to the growth in money supply and other government actions.

Economic Sectors and Investment Outlooks

A Technical Overview (BPNYSE, etc) indicates balanced supply and demand for US and foreign stocks. All time high cash levels exist in

brokerage accounts. Money supply growth is a potential demand indicator. **Suggestion: Hold current positions. Do not add to portfolio equity levels, until the economy slows its rate of decline.** Gold is stable, but foreign markets and most U.S. sectors remain weak.

Economic Sector Analysis and Outlook

Telecom sector stock demand is normal. Hold current positions. **Utility** Sector forecasted 2009 earnings are stable. Dividends are around 4%. Hold current positions is suggested. **Consumer Staples** sector 2009 earnings growth is forecast to be flat (and above all other sectors). Demand is weak, in spite of continued price increases. Hold current positions. A sizeable **Energy** sector earnings fall is forecast in 2009. Fundamentals at oil replacement cost estimates are acceptable. No opinion on the sector. The above sectors have dividend growth candidates for value investors. **Healthcare** sector 2009 earnings look stable. No opinion on the sector. **Technology** Sector opportunities are mixed. Apple, IBM, Oracle, and Google have large cash flows and beat expectations. Selective buying is suggested. The **Consumer Discretionary** sector remains a cyclical area. The Sector Relative Strength is neutral. Selective buying of steady earnings companies is suggested. The cyclical **Materials** sector is performing with negative Relative Strength, while earnings are weak. Below normal portfolio weights are suggested. **Industrial** sector exports (and earnings) to developing countries are slowing. Below normal portfolio weights are suggested. The **Financial Services** sector remains uncertain and very volatile. Stay away. Dividend cuts remain negative. **Economic sector earnings are weak in total.** Stocks are priced at book value. There is liquidity to demand stock prices higher. **Summary:** hold most current positions; but wait prior to adding to equity positions.

International Markets Are Stable

Foreign stock markets rose in March, while the USD (1.32 Euro) held steady. Holding fewer developed economy stocks is suggested. Emerging market stocks rose in March (14%). Normal weights may be considered if you can withstand large declines (-50% in 2008.)

Fixed Income - Less Volatile

U.S. Treasury bond (overvalued) year to date returns (-11%) may be little changed in 2009 as increased supply to finance huge deficits is partly offset by FRB buying. Investment grade

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corporate bonds are unchanged. Money is moving from stock to money market funds. A small portfolio weight in a TIPS fund is suggested. Muni bonds are also suggested for taxpayers in high tax states, who research good general obligations bonds. High single digit after-tax returns at modest risk are possible.

Alternative Investments – Diversification

The Real Estate Investment Trusts (REITs) index continues to fall due to financing concerns and anticipated retail vacancies during the recession. Wait for more information prior to buying REITs. Gold funds are diversifiers. Normal alternative asset 5% gold fund weights are reasonable.

Portfolio Management

Funds have cash (5.5%) to boost stock or bond prices higher. The S&P 500 index is trading at or above normal P/E based on uncertain earnings forecasts. The question is: Will the forecasted earnings occur?

Current portfolio themes are:

Normal Investment Weights

- All U.S. stock caps funds normal weight
- Foreign EAFE funds below normal weights; Emerging stock funds normal wts.
- Fixed income – TIPS and possibly Muni
- Gold
- Only hold stocks in suggested sectors

Disclosure: Personal holdings: 53% Domestic & International Large Cap stock funds, 41% Small/ Mid Cap funds, 6% cash (19% Total International funds)

Sample Portfolios are models Not Client Recommendations

Sample Portfolio A - Moderately Aggressive

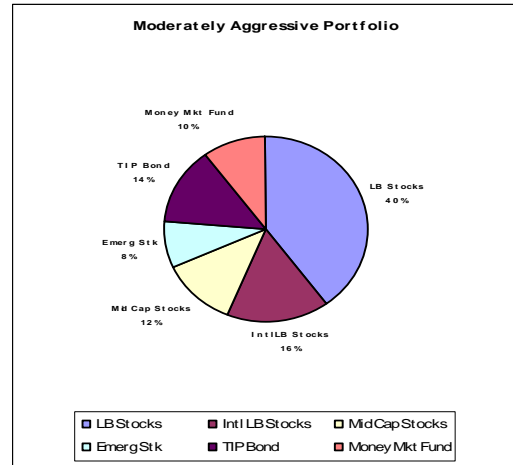
Example 45 year old college educated parents with 1 high school child and 1 college child.

- 40% Large Blend Stock Index Funds
- 16% Large Blend International Fund
- 12% Mid or Small Cap Stock Fund
- 8% Emerging Market Stock Fund
- 14% TIP Bonds
- 10% Money market cash

Note client portfolios use available 401K plan funds and multiple funds in each category to reduce risk.

If I buy, hold, or sell securities discussed herein, then I will disclose my positions. Prices shown are approximate. Joseph Banach. www.BanachWealthManagement.com

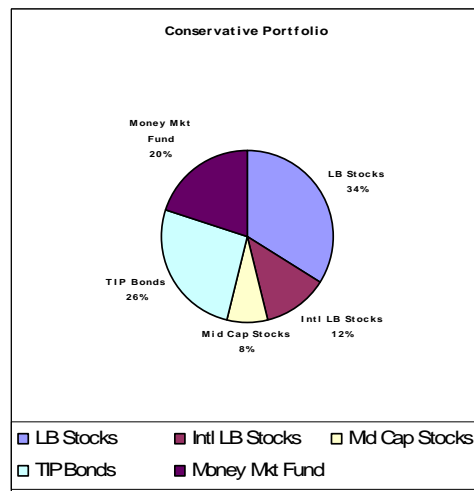
Normal Capital Accumulation –



Sample Portfolio B - Conservative Example 65 year old couple with Social Security Income (20% of spending needs) and Retirement

- 34% Large Blend Stock Index Funds;
- 12% Large Blend International Fund;
- 8% Mid or Small Cap Stock Fund
- 26% TIPS Bonds
- 20% Money market cash

Normal Capital Preservation –



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