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How To Recoup What Was Lost?

April Market Review From Your Portfolio Management Team—May 14, 2009

Investing can be a tortuous affair, taking one step backward for every two steps forward. Looking at the historical record, the S&P 500 index has been negative on average about every four years (going back to 1950). So that data suggests that buy & hold investors should be willing to absorb a negative year for every three positive years. After a year like 2008, buy/hold investors may feel as though they have already taken three steps backward, and things aren't exactly moving forward this year (with the S&P 500 index still close to zero well into the year). Certainly for investors approaching or living in retirement, it is particularly challenging to absorb a loss such as occurred in 2008, with only a hope that the ensuing years will recoup those losses.

	Peak-Trough	Over This Time Frame	Needed to Recoup Losses	March – April Bounce
S&P 500 Index	-50%	Oct 07 – Feb 09	100%	20%

Note: Returns calculated at month end and include dividends.

That is why at FSA, we spend so much energy in trying to protect portfolios from severe market losses. Many of our clients just can't afford to risk a large drop on the hope that future years will get them back on track. The table above shows the peak-to-trough drawdown for the S&P 500 index, as well as how much growth is necessary just to get back to the prior high. Even though the S&P 500 index has made a nice rebound from the early March lows, it still has a long journey in order to get back to its highs from 2007.

Since we spent most of last year heavily in money market, we had little to report in terms of funds we owned; however, that is no longer the case as we have been taking some steps towards investing the portfolios without subjecting them to a heavy amount of risk. Below we list the top holdings within the various FSA strategies:

- **Schwab U.S. Treasury Money Market**
  On average across all of our strategies, we have roughly 60% of our client assets in money market. For most clients the money market we use is the Treasury money market. Earlier this year, Schwab closed this fund since it has grown so

large and yields were declining. So, for any new accounts or new clients, we are using either the Schwab Government Money Market Fund or the Schwab Premier Money Market Fund.

As credit conditions have stabilized this year, we are getting more comfortable in considering moving all of our money market assets from the Treasury money market to either the Government MM or the Premier Money Market. While yields remain quite low among all money market funds, we want to use the highest yielding fund that is available as soon as we feel the risks are low enough.

- **High Yield Bonds (Tactical Growth, Conservative Growth, Income & Growth, Income)**
  FSA has a long history in using this consistently trending asset class, especially after recessionary periods. These bond funds are more aggressive than investment-grade bonds, and in fact tend to move as much with stocks as they move with other bonds. As a result, these types of bonds can often generate very strong returns in the right environment.

  This asset class had its worst year ever in 2008, and this has presented a wonderful opportunity for investors who believe the U.S. economy is not going to repeat the Depression of the 1930s. While we don't know the ultimate future of the U.S. economy, we believe the opportunity is compelling enough to add some of these funds to our portfolios. As always, we have our safety nets in place in case the market deteriorates over the summer.

- **Multi-Sector Bond Funds (Core Equity, Conservative Growth, Income & Growth, Income)**
  As the name implies, these funds tend to own a variety of bond types—including high yield bonds, high quality bonds, and even foreign bonds. Since we favor both high yield and high quality corporate bonds, these funds make sense in this environment.

- **Investment-Grade Bond Funds (Conservative Growth, Income & Growth, Income)**
  These funds invest in high quality corporate and government bonds. We see this area as a good way to capture significantly better returns than a money market without having to suffer through too much volatility. If the market environment improves into the summer, we may replace these funds with more aggressive alternatives. As long as risks seem high, these funds offer a nice yield with some modest growth potential.

- **'Wimpy Equity' Funds (Core Equity, Income & Growth)**
  We use the term 'Wimpy Equity' to refer to a group of mutual funds which we use quite often. These types of funds tend to hold up very well in bad markets, which allow us to own them in all but the worst market conditions. Usually, these funds employ very eclectic strategies which enable them to survive most bear markets without getting hit too badly.

  As the market has rebounded recently, we remain concerned about the long-term viability of the market, and yet at the same time, we want to participate if the rally carries on into the summer. These funds give us the opportunity to capture at least a portion of the equity rally, while offering excellent protection if the rally suddenly reverses course. And of course, we always keep our safety nets in place to further protect our portfolios from serious damage. As soon as we see signs that the overall uptrend is resuming, we will add more traditional equity funds to our portfolios. At this point, the stock markets remain very treacherous and we believe a healthy dose of skepticism is warranted.

Please let us know if there is anything we can add to these monthly reports that would help you understand what is happening in your accounts.