

Current Observations

FINANCIAL & INVESTMENT MANAGEMENT GROUP, LTD. • FEE-ONLY WEALTH MANAGEMENT



by Paul Sutherland

Nothing Happens'til Something Moves

Can they make decisions? Can they act? Can I rely on them to do the tough things? That was my response when asked what characteristics I would look for in a money manager. Of course a similar answer would be given about essential qualities for any political candidate or CEO.

I went on to explain that many people are wired to just acquire information but never to apply it. An entrepreneur was telling me about a business school in which 8 out of 10 business faculty had never ran a business, owned a business or worked in the private sector. Amazing I thought; all theory no experience. Similar to our politicians, who I often think believe their job is to talk, study, argue, and not to “do”.

Acquiring information is valuable, disseminating it is critical, but it appears for many that applying it is rather difficult. Or they believe that action is unnecessary. Sadly inaction can cause a crisis to deepen beyond the necessary.

"I never worry about action, but only inaction." Winston Churchill

Regardless of market volatility, history demonstrates that people will still travel, eat out, go to school, buy flowers, make deposits and withdrawals, shop and do other activities. Yet many investors, politicians, and business people seem caught in a quagmire of inaction or fear-based action, centered around the theme that financial markets are on the brink of further collapse.

The chart below adds some historic context to today's banking crisis.

The cost of the banking crisis

	Date	Costs (US\$bn)	% of GDP	
Great Depression*	1930s	1.1	2.0%	
Savings and Loans	1986-95	175	3.0%	
Swedish banking crisis	1992-93	9.2	3.6%	
Japan banking crisis	1990-99	600	13.0%	
US subprime crisis**	2007-	605	4.4%	

Source: IMF,UBS estimates.

* Measured by the amount of bank preferred stock acquired by the RFC;

** as a percentage of US GDP.

What is interesting about the four previous bank crises is that they were caused, according to a UBS analyst, by real estate price bubbles that flowed through the financial system causing loss of confidence in the banking system and creditor and depositor runs.

Historical accounts indicate President Hoover's political inaction to address issues before the depression. Our own Zach Liggett had first-hand experience while living in Japan during the epidemic stages of its banking crisis and cannot contain his ire regarding the slowness of the bureaucrats both in Japanese government, and with businesses. Perhaps the lessons from Japan and our inactions in the '30s have instigated the FED's swift action to help our economy through the current U.S. subprime crisis.

Most investors know that markets are cyclical; they at least read about the great depression in school, know about inflation and recognize that economics is about humans interacting with goods and services, time and money, in-

continued on page 2

Nothing Happens..., contd.

vestments and ideas. So why are people reluctant to invest in today's markets? Can investors not be forward thinking and consider this crisis an opportunity?

The key is to put the banking crisis into perspective and seek out opportunities. If you borrowed to buy homes with second and third mortgages and overextended credit cards, you're in a crisis. If you owned securities in an entity that, through lack of discipline and simple management, loaned to speculators then your portfolio is in a crisis. If you have been smart and made the right decisions then you are available to take advantage of the opportunities.

For example, JP Morgan was not silly in its risk management parameters and recently purchased Bear Stearns, at a fraction of the \$18 billion it was selling for last May. Bear Stearns stock last May was \$159- it is now being bought for \$10 a share by JP Morgan. Our FED did act when they saw the risk and caused Bear Stearns, who was leveraged 44 to 1, to sell for about 6% of its former value. Sadly, it is estimated that one third of Bear Sterns stock was owned by employees who in many cases have watched their net worth collapse as their company's speculative practices did not reward them for the extreme risk they took on.

The point of this essay is not so much about the crisis and opportunity relationship, it is that knowledge must be challenged, continuously reviewed, and prudently used. An action-oriented decision-based system that challenges the current paradigm approach is what separates success and is required for continued prosperity.

As investors we must do something during these markets. Aristotle talked about phronesis which is the root of the word prudence and is the ability to think about how and why we should act in order to change things for the better. Aristotle linked phronesis with foresight, requiring that a prudent virtuous person should

be thinking of the future consequences of choice and carrying out future acts with education, organization, efficiency and effectiveness. Investors must be prudent in their actions and of course are held to practice phronesis, by always evaluating how to prudently act to improve client portfolios.

In February FIM Group welcomed a number of new clients. Many came to FIM Group because of three reasons:

- 1) They found their former investment manager did little in the way of management.
- 2) They were handling their own investments and were frustrated by the results.
- 3) They felt a forward-looking, common sense, global total-return approach was more rational than their current manager's passive, inactive, or specialized style.

As Einstein so eloquently stated, "nothing happens 'til something moves." And certainty the financial markets are moving. Trillions of dollars have been permanently lost by some and trillions of dollars will be made by those who use informed prudence as their guidance and buy solid investments from those that stand in fear, were imprudent and forced to sell (as in Bear Stearn's case), or panic.

For my birthday Amy gave me the New York Times Best Seller, *Andrew Carnegie* by David Nasaw, a biography of one of America's most famous and successful businessmen and philanthropists. What is interesting about Mr. Carnegie was his straightforward approach to seeing opportunity where other saw crisis, pain and hopelessness. He created part of his fortune during the Civil War, by investing when others were timid, lethargic or guided by fear.

"The first man gets the oyster, the second man gets the shell."

Andrew Carnegie

Nothing Happens..., contd.

I am optimistic that our clients and our investments will be part of the trillion dollars made going forward that I can barely wait for my alarm to go off in the morning to get to the office.

We at FIM Group are energized by the opportunities we see in the markets and know the bottom line is that the markets will always move and future profits come from today's actions.

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This month we will be giving away a copy of Andrew Carnegie to our FIM Quiz winner. See the back page for more details.

Picking Through the Gloom: Japan Field Trip 2008



by Zach Liggett

A *mari yoku nai* (“not very good”) was the consensus response from a non-scientific poll of investors, analysts, local brokers, managers, and cab drivers I met on a recent two-week research trip to Japan. The question posed was sim-

ply, “how is the mood in the Japanese market?” Given Japan’s high regard for reserved politeness, a true translation would probably amount to something like “the market stinks!”

The doom and gloom in sushi-land should be somewhat anticipated given the –30% return in Japan’s broad Topix stock market index over the past twelve months. Rising oil prices (+59% in yen terms year/year to March 18), a strengthening currency (+20% v. the greenback over the same period), and continued political malaise have not done much to help the sentiment either. Optimism for Japanese stocks was indeed in short supply during the trip, although my travels did turn up a few stalwart, longer-term oriented Japan specialists with a considerably contrarian view. These lone voices professed that the consensus is far too pessimistic and that the current Japanese stock market actually presents a once in a lifetime buying opportunity.

From a top-down view and looking strictly on a valuation basis, the Japanese stock market does in fact look cheaper than it has in a long time. The price-earnings ratio of the Topix index is now at a 33-year low and its price-book ratio is well-below its historical average levels (Figure 1). The “yield gap” between the stock market’s dividend yield and the ten-year

Figure 1 Japan Topix Stock Market Index Price/Book Ratio *Source: Bloomberg*



continued on page 4

Picking Through The Gloom, contd.

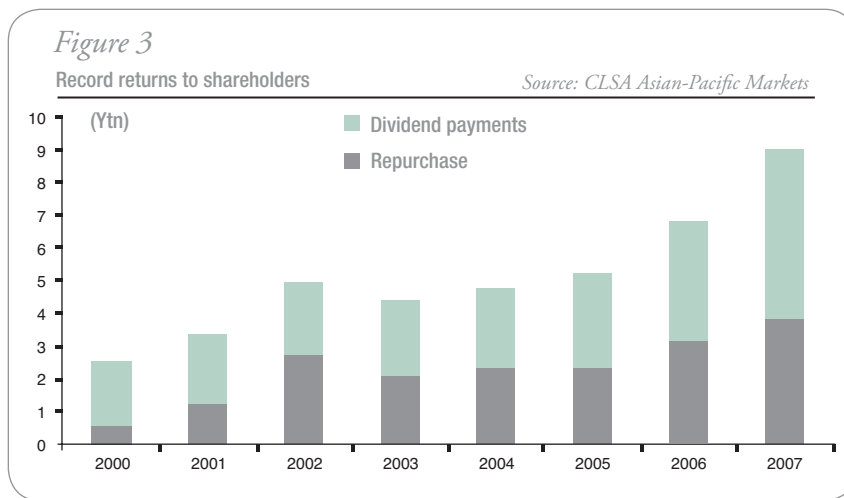
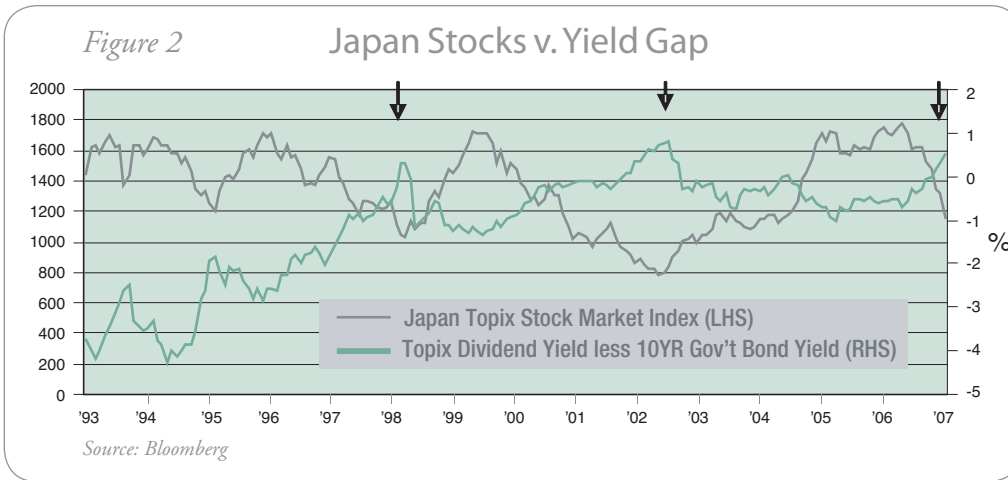
Japanese Government Bond (JGB) yield also suggests that Japanese stocks are inexpensive (at least relative to bonds, Figure 2).

Also on the positive front are subtle signs of hope that corporate Japan is finally starting to treat shareholders with more respect. The trend in share buybacks and dividend payouts, as noted by local research house CLSA Securities Pacific, made record new highs in 2007 (Figure 3).

For example, the aforementioned ten-year JGBs pay a pitiful .3% yield after stripping out inflation (yes there is a decimal in front of the six!). And the overseas investment products that have sucked capital out of Japan over the past few years are now turning sour as the yen surges against many foreign currencies including the US dollar (Figure 4).

As for my company visits (I met with approximately 30 companies on the trip), I did

come across several pockets of optimism. Kyoto Kimono Yuzen for one, seemed upbeat about the stabilization of order trends for its traditional Japanese garments and opportunities to win a larger share from struggling smaller players.

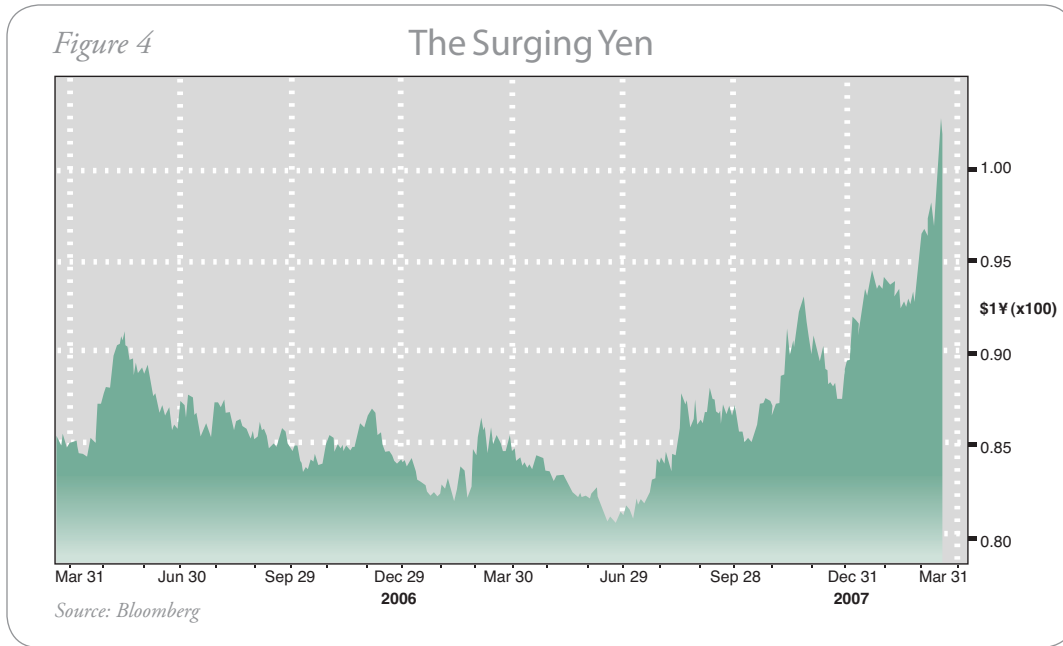


And management at Tose, a small videogame software developer, spoke of progress on its restructuring initiatives at a China subsidiary and strong global demand for its game development services. Both of these companies maintain solid balance sheets, show good long-term growth potential, and trade at less than 10x earnings. Kyoto Kimono Yuzen, also pays a 5% dividend yield, one of the higher yields in Japan.

Should cheap valuations and better corporate governance fail to entice investors back into Japanese stocks, perhaps the lack of compelling alternatives (at least for local investors) will finally do the trick.

At other companies like Kansai Paint, the outlook for external growth had management most upbeat. Japanese carmakers have long pursued overseas markets as part of their

Picking Through The Gloom, contd.



long-term growth strategies, and Kansai Paint has been happy to tag along for the ride. This is particularly the case in India where Kansai Paint commands 60% market share in automotive paints. Despite near-term margin pressure from higher raw material prices, Kansai Paint should do well over the longer-term as Japanese auto-maker customers like Toyota continue to gain traction in the massive Indian market. The stock trades at only 11x earnings, a level that we believe undervalues the quality of Kansai Paint’s assets and its global earnings growth potential.

While most of my company visits were typical green-tea-in-the-boardroom with senior management affairs, my trip to Sekisui Chemical’s prefab housing factory included a bit of a twist. Actually quite a twist as I was offered the chance to “experience” first-hand the effects of two of Japan’s largest ever earthquakes at Sekisui Chemical’s earthquake simulator. I survived both quakes as did the Sekisui home module I stood in, which was reassuring given the company’s promotion of its homes as quake-resistant. Sekisui’s stock has been weak of late as the rising oil price hurts profitability at its high performance plastics unit and continued Japanese consumer sluggishness weighs on home sales. But

with very strong product lines in prefab homes, high performance plastics, and urban infrastructure and trading at 10x earnings, we believe that the stock offers good long-term value.

All in all, the gloom in Japan seems overdone. With market valuations the cheapest they have been in quite some time, corporate Japan shareholder friendliness on the rise, and a wide variety of compelling company-specific investment stories, we continue to see good potential for solid long-term total returns in our Japanese holdings. While we might not yet be ready to join sides with those calling Japan the “buying chance of a lifetime”, we do see plenty of opportunities for our portfolios and continue to pick through the gloom accordingly.

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To learn more about the companies in Zach's article visit:

www.kyotokimonoyuzen.co.jp

www.tose.co.jp

www.kansai.co.jp

www.sekisui.co.jp

FIM News

Zach Liggett, portfolio manager, recently attended the Globe 2008 Conference in Vancouver. He joined thousands of corporate executives, government decision makers and leaders of the environmental industry to discuss corporate sustainability, climate change and energy, finance and sustainability, building better cities and the future of the automotive industry.

Kevin Russell CPA, CFP® of FIM Group recently attained the Chartered Retirement Planning Counselor (CRPC®) designation from The College for Financial Planning. The CRPC® program focuses on the pre- and post- retirement needs of individuals, focusing on the retirement planning process and meeting multiple financial objectives.

The Quiz

In what profession did Andrew Carnegie begin his career?

- A. weaver
- B. miner
- C. Bobbin boy
- D. telegrapher

Answer online at fimquiz.com and register to win a complimentary copy of the new biography, *Andrew Carnegie* by David Nasaw. You can also call 1.800.632.5528

Quote

The gods cannot help those who don't seize opportunities—Confucius, c. 500 BC

Asset Protection with Schwab

With the recent news of Bear Stearns we at FIM thought it was appropriate to revisit our relationship with our custodians. Many of our clients' accounts are held at our main custodian, Charles Schwab. The Charles Schwab Corporation's internal protective practices and stringent business standards are designed to keep clients' assets safe.

Schwab's asset security measures offers protection for securities and cash by the Securities Investor Protection Corporation (SIPC). Accounts of Charles Schwab and Co., Inc are insured by SIPC for securities and cash in the event of the broker-dealer failure.

Additional brokerage insurance-in addition to SIPC protection-is provided by Charles Schwab & Co., Inc., accounts through underwriters at Lloyd's of London. This additional protection becomes available in the event that SIPC limits are exhausted. Some custodians do not offer any additional brokerage insurance beyond SIPC coverage. Schwab believes clients deserve to be protected by a well-respected name in the insurance industry.

More information about SIPC coverage is available at www.sipc.org.

Learn more about Schwab's Financial Results by visiting www.aboutschwab.com

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