

Current Observations

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

2008 - YEAR OF THE PRACTICAL

by Paul Sutherland



As President and Senior Portfolio Manager of FIM Group, Paul has been managing global investment portfolios for over 22 years.

Paul's latest book, "AMA Physicians' Guide to Financial Planning" was recently published by the American Medical Association. More information at: <http://www.paulhsutherland.com/ama>

My sister called to tell me about a friend that bought an investment over the internet that promised a 1.5% return per day. This got me wondering, how could someone of sound mind and common sense believe that there was a possibility of earning 1.5 % per day? What practical person would send their money off via the internet to purchase a security without reviewing and researching? When I look at some of the conservative closed-end trusts down 30% from this summer and the absolute speculation last year in energy, gold, banking, and Chinese stocks, I wonder if the average investor will finally learn that investing must be grounded in common sense. Of course, with investing you get paid to take on risk, but not to be impractical or foolish. Patient long-term investors need to buy investments that offer solid value and know that the value of the investments will eventually be realized. I think we all want to dream about an investment with yields of 1.5 % per day. My wonder is, will investors put their brains back on and make 2008 the year of the practical? If this philosophy regains favor in 2008, it should be a year of good performance. Even in a struggling economy, investment success is possible as dividends and interest are collected and companies grow from reinvesting their earnings.

I think 2008 will be a return to the classic, practical investor who wants to make money and is sensitive to price. The guidance of what to buy will be steadfast to the price / value relationship. In other words, what you pay for an investment will once again matter along with management, judgment and analysis. With all the activity in our portfolios at year end, it might be helpful to remind our clients that we always construct and manage our portfolios for sound long-term success.

Management is the key to achieving investment success, because everything changes and no investment is right all the time. The key to risk management is looking at the down side twice and the upside once. Government bonds are great when rates are stable or declining. Stocks are great when the yield (what percentage the stock returns relative to its price) is high and the expected returns compensate an investor for the risks. Allegorically and practically, we spend much of our time looking to buy dollar bills for fifty cents. What is interesting is that few seem to pursue these fifty-cent dollar bills. Rather, most investors seem attracted to pay for investments after they have doubled or tripled in value - not when they are bargains.

"Maturity teaches us that everything changes. This is why active management is essential for success."

Maturity teaches us that everything changes and investment management that can anticipate, preserve wealth, and capture opportunities is the real key to good, forward investment returns. But what is a bargain-priced investment? What does it look like? What are its characteristics? Most importantly, what is a great investment to achieve responsible returns?

continued on page 2

2008 - YEAR OF THE PRACTICAL

Thankfully investments and investors are cyclical. Investors tend to embrace a type of investment for a time period, like real estate investment trusts (REITs). Until recently REITs were on a tear. Now, the BBREIT index is down from a high of 295.78 on February 9, 2007 to 188.7 as of January 4, 2008. Most REITs had all of the qualities you want for retirement investments. They provide expected increasing income, tangible assets and attractive income and growth investment attributes. Of course every investment return is affected by the price you pay for it. Ten months ago if you bought a REIT that was expected to pay an \$1 annual dividend you might have paid \$25 for the right to that \$1 of income, for an income return of 4%. Today you'll pay around \$16 for that same hypothetical investment. Paying \$16 for that \$1 income brings the income up to 6%. (\$1 divided by \$16). Bottom-line price matters even in retirement income and growth investing.

Examples often demonstrate best, so below we have highlighted a sampling of the investments we own right now in our income-oriented portfolios. We will start by highlighting a real estate company we hold in our portfolios today.

HRPT Properties Trust (HRP) HRP is a real estate investment trust (REIT) that has a distribution rate of over 11% at a share price of \$7.50. HRP was selling for \$13.67 on February 15, 2007. For investors that paid \$13.67 their yield at cost is around 6%. The investors that paid \$13.67 a share were paying substantially more than the shares were worth. They purchased HRP because REITs were hot and pushed by brokers, newsletter writers and Wall Street. But we started buying the shares between \$8 and \$9.15. Our yield at cost is over 9%. HRP owns \$6 billion worth of office buildings in central business districts and suburban areas in 34 states and the District of Columbia. The trust's management team balances growth and stability by leasing to the U.S. government and medical organizations that typically sign long-term leases. To maintain growth HRP owns properties with good appreciation and lease rate increase potential.

United States Treasury Inflation-indexed Bonds (TIPs) TIPs are currently the largest holding in our retirement portfolios. In the first few days of 2008 these investments rallied quite strongly and we took those profits to buy floating and fixed-rate preferred income investments yielding between 6% and 8% respectively. These securities are currently attractive because they provide a U.S. government-backed AAA current income, with long-term protection of purchasing power, and the right to receive the maturity value when they reach maturity. The interest rate fluctuates with the inflation rate - thus their current return rises and falls with the rate of inflation. On the bonds we bought for clients on November 30th the rate we locked in was 1.935% plus inflation. So no matter what, the bonds will pay nearly 2% more than inflation. Right now in this low-interest-rate environment, with the uncertainty about inflation, the declining value of the U.S. dollar, and the housing and mortgage crisis, we feel that TIPs are a better deal than straight U.S. treasury bonds, long-term CDs and similar vehicles.

Babcock and Brown Wind Partners (BBW) BBW is a \$1.5 billion Australian company which owns interests in quality wind energy generating assets. The investment rationale for wind energy is compelling. Wind does not contribute to global warming, and reduces dependence on oil, coal, and other non-renewable resources. Wind energy is cost competitive against new electricity generation plants and current high fossil fuel costs. The International Energy Agency projects that demand for electricity will double between 2002 and 2030, and that one third of the current capacity will need to be replaced by 2030. Twenty four states have renewable energy targets and many developed countries have legislated reusable energy targets. Currently BBW has 68 wind farms in six countries on two continents and sells mostly long-term contracts at inflation-linked prices. At today's price of \$1.68, BBW pays a current yield of over 7.75% and we expect that to increase over time. We have many energy investments in our client portfolios and feel that the companies positioned to profit from

continued on page 5

THE SUPER-RESILIENT CONSUMER

by *Suzanne Stepan*

The day after Thanksgiving first became known as Black Friday because the heavy crowds of shoppers drew comparisons, apparently, to the stress and chaos of “black days” such as Black Tuesday from the 1929 stock market crash. Perhaps more appropriately, in recent times Black Friday now generally refers to the time when many businesses are “in the black” due to financial gains posted from strong consumer spending.

I recently read that 58 million American shoppers made their way into traditional brick-and-mortar stores this year on Black Friday. Okay, I may have actually been one of those shoppers. But the details are now becoming hazy as I repress the memory. In any event, this year’s Black Friday gave retailers approximately a \$10.3 billion boost on holiday purchases. ShopperTrak RCT Corp., a Chicago-based firm, reported that this year’s outlay was 8.3% higher than one year ago.

On the other hand, Cyber Monday is the Monday immediately after Black Friday. This is the day people go back to work and begin their holiday season shopping, hopefully during their breaks. According to the National Retail Federation, 61 million consumers were expected to shop on-line at work this year and this is up from about 51 million in 2006. Just as Black Friday is expected to be the busiest brick-and-mortar shopping day of the year, Cyber Monday has been claimed as the busiest on-line browsing day of the year.

While retailers had a decent start to the holiday shopping season, will it be enough to make up for the lost sales that took place throughout the year? The answer is yet to be fully determined and in the meantime, the U.S. is in need of a new comic book superhero. Is it an interest-only mortgage? Is it a 12-mpg SUV? No. It’s the Super-resilient Consumer, dedicated to keep on spending and performing the juggling act.

The American consumer does not seem to know when to stop spending feverishly. This does not make much sense given the

current state of the mortgage crisis.

We have all heard the media draw attention to the sub-prime mortgage debacle and most people would agree that the global credit crunch has been the headline economic and financial concern of the year. In the past quarter, Citigroup Inc. reported that it had lost more money than it made in the four years that it had structured and traded financial instruments based on U.S. sub-prime mortgages. In mid September, Northern Rock, a large British mortgage bank, was unable to raise funds from the capital markets and requested an emergency bailout loan from the Bank of England. While Northern Rock had little exposure to the shaky U.S. mortgage market, it was their inability to raise capital during a period of time when liquidity was nonexistent that caused them problems. Northern Rock had a flawed business model. They ran into tough times because they did not rely on consumer deposits to finance their mortgage lending but, rather, chose to depend heavily on raising money in the capital markets. When the liquidity dried up, the bank got squeezed and their customers panicked.

Oddly, when the chief executive of Northern Rock was asked if he would have run the same strategy knowing the credit crunch was coming his response was: “No, hindsight is a great thing, and I don’t think anybody else saw this coming either.”

In the meantime, threats of choking economic growth have pressured both the U.S. Federal Reserve and the European Central Bank to keep interest rates low. Structured investment vehicles, referred to as SIVs, have also been rocking our world. These are forms of collateral debt obligations that invest in a wide range of asset-backed securities. SIVs are open-ended which means they are expected to stay in business forever, as old assets mature new assets are purchased. These products are created to make profits from a gap between short-term borrowing rates and long-term returns. As with all investments there are risks. Liquidity is imperative because the SIV borrows

THE SUPER-RESILIENT CONSUMER, CONTD.

in the short-term and invests long-term. Should the out payments on the borrowed funds come due before payments from the investments are made, the borrower is forced to refinance at current short-term rates. Unless the refinance is made at a favorable rate, the asset may have to be sold. Thus when liquidity dried up, the market for SIVs became nearly insolvent.

Even the U.S. stock market, acclaimed for its resiliency, has suddenly been finding it difficult to put a confident spin on a dangerous concoction of colossal banking loses, a housing bust, a credit crunch, inflationary pressures, the plunging dollar and high oil prices. Through thick and thin, however, the Super-

resilient consumer appears to be juggling it all.

While we at FIM Group continue to position for long-term positive returns regardless of market conditions, we have had sluggish relative performance periods such as 2007 and have emerged with positive long-term results. The investment team continues to see significantly more macro risk in the current market and continues to protect against negative market scenario impacts such as those mentioned in this article. **F**

Suzanne joined FIM Group in September 2003 as a portfolio manager in the Michigan office. Before joining FIM Group, Suzanne was employed by Noddings Investments as a Vice President and Senior Portfolio Manager



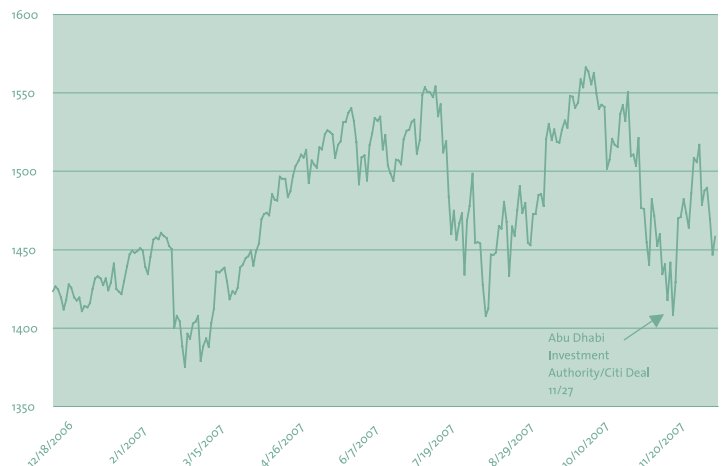
INVESTMENT COMMITTEE BRIEF

Item: Sovereign Wealth Funds to the rescue! The Abu Dhabi Investment Authority injects \$7.5b into Citigroup while the Government of Singapore Investment Corporation invests \$9.7b into Swiss banking giant UBS.

FIMG Response: Sovereign Wealth Funds (SWFs), basically the investment arms of sovereign entities, now control an estimated \$3 trillion in assets. This makes them a larger potential market factor than hedge funds or private equity firms. With U.S. stock market confidence waning, the recent high-profile investments from the SWFs could not have come at a better time. Indeed, Abu Dhabi's November 27 Citigroup investment stopped a decline that threatened to push the U.S. stock market through year-lows (see chart). Much of the growth in SWF assets derives from massive petro-dollars looking to be recycled, and with crude stubbornly above \$90/barrel, SWFs are likely to remain well-oiled (Ha!) to fund further headline-making investments. As David Wessel pointed out in a recent Wall Street Journal article though (The Risks of Sovereign Funds, December 13, 2007) the prominent entry of SWFs into the U.S. equity market poses risks in the form

of possible backlash and xenophobia, questionable motives of the SWFs (not necessarily value maximization), and clutziness (large investors make mistakes too). These risks warrant careful monitoring as does the risk that the stock market reaction was a bit premature. After all, while the billions invested in Citigroup and UBS certainly provide some relief, the \$12.7 trillion U.S. banking system remains plagued by confidence and solvency issues that are likely to play out for some time to come.

S&P 500 Stock Index



*source: Bloomberg

2008 - YEAR OF THE PRACTICAL

the changing landscape of energy generation, conservation, and efficiency will thrive and have a good long-term sustainable future.

Oesterreichische Post AG (Austria Post) Austria's leading mail carrier is a recent addition to our client portfolios. Austria Post pays a 6% dividend based on our cost (the share price has gone up nicely since we bought it) and we expect the dividend, which is paid in Euros, to increase over time. Austria Post distributes mail thru 1,300 post offices in Austria. It also has a logistics and parcels business similar to UPS or FedEx. Austria Post is working to solidify its market-leading position in Austria, and has begun efforts to expand its business in Central and Eastern Europe.

Independent News and Media (INM) INM is a \$2 billion in sales, global media company with significant businesses in Australia, South Africa, U.K. and India. INM owns 20% of India's largest-selling newspaper along with other media assets like radio stations, outdoor advertising, web sites and other global content-based properties. The company's shares were bought at a bargain price to pay nearly a 6% dividend in Euros at our cost.

In the early 1980s we were able to buy U.S. bonds, AAA bonds at yields over 12%, and companies such as telephone providers in the Philippines and Mexico at great yields. In addition, drug stocks sported great yields when the prospects of national healthcare scared investors from the market. We bought and profited handily when people realized that the drug companies would still be profitable under Clinton's plan. Much has changed, of course, and new areas of opportunity must always be sought. Today, we invest in companies like the New York Times, Gannett (publisher of USA today) and Independent News, which sport great yields and bargain prices.

We have been selling some of our TIP investments to buy bank, REIT and financial companies' preferred stocks. We believe that

these securities are selling at incredible bargain prices, and we have been consistently buying them for client portfolios. Fixed preferred stocks that were paying between 5% and 7.75% only six months ago are now at yields of between 8% and 10%. Floating-rate preferred stocks are sporting yields around 20% to 30% higher than six months ago. Bank investors are panicking and the panic is feeding on itself. Banks did loan money to some homeowners that will not be able to pay them back, but thankfully they did not bet the farm on those SIV investments and shaky home owners. We believe that banks will get back to basics and practicality. However, when you listen to the news and watch what has happened to bank stocks you could wonder if we are headed beyond a normal cyclical economic recession.

We are confident that banks will raise capital, cut expenses, manage their loan issues and continue to pay their bills and dividends. There is strength in diversification and that is why we

"We are confident that banks will raise capital, cut expenses, and get back to basics"

have bought many financial, REIT, and bank common, high-yielding preferred stocks. While six months ago we held no bank preferred investments and only a few bank stocks, now at these bargain prices we hold over a dozen different bank stocks with different characteristics. We also own investments in giant banks, tiny banks, and banks working in nearly every region the world. As always practicality, prudence and common sense guide us to diversify.

A common question we get is "When do you sell an investment?" Two reasons: 1) It reaches the point where its future returns do not compensate you for owning it, or 2) you find something you like better. For example we have sold off some TIPs bonds, and stocks to make room for many of the investments mentioned above. Selling investments can be hard but it is necessary to investment success. A sell discipline is as important as a buy discipline.

2008 - YEAR OF THE PRACTICAL

Of course investing takes time, talent, and skill but in the end it is all grounded in common sense, which according to my sister's story is not so common. I think as investors become wiser from experience, they will become more practical which can benefit our clients and the market in general. The landscape is constantly changing and we at FIM Group continually adjust our

strategy so that we can effectively identify, evaluate, and pursue potential bargain investment opportunities. **F**

* source: Bloomberg

Here is a guide to the maximum amount you can contribute or defer into your retirement accounts for the 2008 plan year. The 2007 limits, many of which are unchanged are included in parentheses.

Type of Plan	Maximum Contribution Limit
Traditional IRA	\$5,000 (\$4,000)
Traditional IRA catch up(age 50 & older)	\$1,000 (\$1,000)
Roth IRA	\$5,000 (\$4,000)
Roth IRA catch up(age 50 & older)	\$1,000 (\$1,000)
SIMPLE IRA Plan	\$10,500 (\$10,500)
SIMPLE IRA Plan catch up(age 50 & older)	\$2,500 (\$2,500)
401(k) & 403(b) Elective Deferrals	\$15,500 (\$15,500)
401(k) & 403(b) catch up(age 50 & older)	\$5,000 (\$5,000)
Maximum Defined Contribution Addition	\$46,000 (\$45,000)
Maximum Defined Benefit Annual Benefit	\$185,000 (\$180,000)

Quote of the Month

"The time of maximum pessimism is the best time to buy and the time of maximum optimism is the best time to sell."

- John Templeton

Quiz Central

What year was the first Wall Street Journal published?

- A. 1890 B. 1889 C. 1901 D. 1916

Answer online at fimquiz.com to be eligible for a monthly prize. You can also call 1.800.632.5528

Founded in 1984, Financial & Investment Management Group provides global investment management solutions to individuals, corporations and advisors. Our dedicated and talented team of 43 professionals work from offices in Traverse City MI, Onalaska WI and Maui HI. FIM Group actively manages more than \$600 million in client assets.

PUBLISHER - Financial & Investment Management Group, Ltd. (Hereinafter referred to as "FIM Group") "Current Observations" is published twelve times per year, 111 Cass St., Traverse City MI 49684 Telephone: 231.929.4500 Fax: 231.995.7999 Email: info@fimgroup.net; Web page: www.fimgroup.net This and all editions of "Current Observations" is reviewed by the FIM Group Investment Policy Committee. All information presented herein has been compiled from sources believed to be reliable. However, no representation or guarantee is made as to the accuracy or completeness of information obtained from third parties. Readers are further advised that successful investing is more art than science and therefore no strategy, chart, graph, theory, philosophy, method, system or formula discussed in this newsletter can guarantee favorable results. FIM Group, its officers, directors, employees, and members of their families (hereinafter referred to as "associated persons") may have established positions in securities that are recommended for purchase by FIM Group in this publication. FIM Group believes in following its own advice and encourages its associated persons to invest in accordance with the advice provided to its clients and/or subscribers. FIM Group Client account transactions are given priority over those of its associated persons. Unless otherwise stated, all opinions in this newsletter are those of the individual FIM Group Representative preparing the article and are expressed with the understanding that (1) the opinions are not based upon the individual needs or investment objectives of any individual reader or group of readers, (2) readers will seek independent investment advice from their adviser before making any investment decision, and (3) any favorable comment or recommendation made in this or future issues is not a representation or guarantee that following the recommendation will result in a profit or reduced loss. All rights reserved. Permission to reprint any material herein is granted provided full credit (including address) is given to FIMG. In addition to publishing this newsletter, FIM Group provides investment counsel, portfolio management and financial planning services to its clients. Subscriptions to "Current Observations" are provided without cost to FIM Group's clients.

As per SEC Regulations, this is to inform all interested parties that Financial & Investment Management Group, Ltd.'s FORM ADV PART II is available upon request by writing FIMG at: 111 Cass St. Traverse City, MI 49684