

# Current Observations

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

## Road To Recovery



by Paul Sutherland

A recent article in the global edition of The New York Times discussed a report on consumer confidence about the stock market. The Conference Board found that 55 percent of the consumers surveyed in July “expected stock prices to decline over the next 12 months, while just 18 percent expected them to rise.”

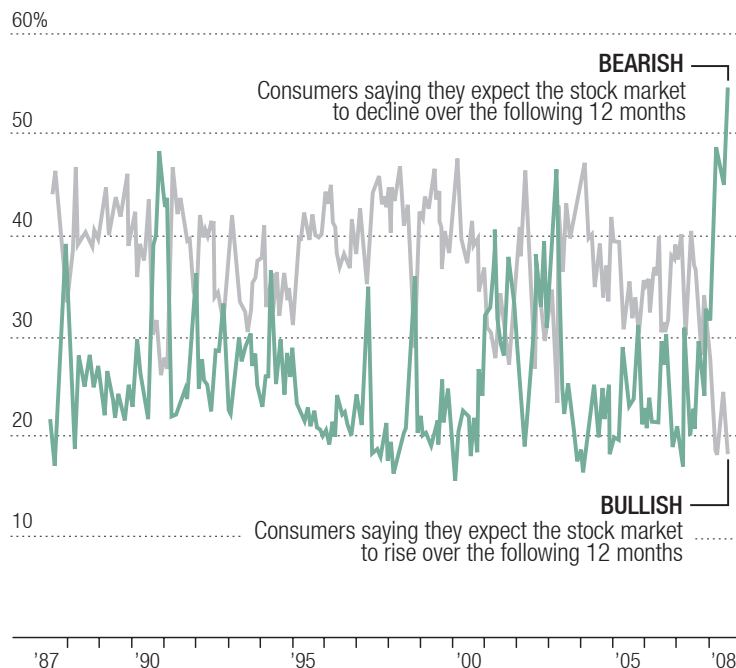
This is great news for investors like us. If you are a long-term investor, the cheaper an asset costs, the better. Prices on stocks have increased over time, and history shows that almost anywhere you invest, if you’re patient, you’ll end up a winner, though only a modest winner if you buy at high prices. If you own more investments when they are priced right,

you do better; and if you’re a global investor, the balance is even more to your favor. History demonstrates that selective, patient investors, who own securities that are priced right, with good value and future prospects, do even better. So today our FIM Group portfolios have four things going for them:

1. There are lots of “stocks” priced right, with many paying solid dividends while we wait for markets to recover.
2. We are global investors, and there are many stocks in other countries that are priced significantly better than U.S. stocks, especially if you consider the growth prospects of companies in emerging economies.

### Forecasting Stock Prices

For the first time, more than half of U.S. consumers polled by the Conference Board expect stock prices to fall over the next 12 months. There have been six previous cycles when at least 36 percent of respondents were bearish.



Source: Conference Board. Percentage expecting stocks to remain level are not shown.

DATE OF PEAK	PERCENT BULLISH	PERCENT BEARISH
November 1987	34%	39%
S&P 500 OVER NEXT 12 MONTHS		
	<b>+19</b>	
October 1990	27	48
	<b>+29</b>	
December 1991	30	36
	<b>+4</b>	
April 1994	29	36
	<b>+14</b>	
October 1998	29	36
	<b>+24</b>	
March 2003	23	47
	<b>+33</b>	
<b>Current</b>	<b>18%</b>	<b>55%</b>

## ROAD TO RECOVERY ... continued from page 1

3. We have responded well during recoveries after bear markets.

4. We are patient, long-term investors.

FIM Group was just three years old when the stock market crashed in 1987. I remember a young client called me up and said, "Because of the crash, I'm down about 17 percent from my portfolio's high value and as a result my risk tolerance has changed. Sell everything and put me into T-bills." I chatted for a long time with that client about the meaning and use of risk tolerance.

At that time, I also co-managed a trust with two other managers for a trust company in California. We each managed about one-third of the assets. During the crash my portion of the trust went down much less than the others. I received a phone call from a trust officer informing me that the other two managers were fired because of their portfolios' poor performance and offered me the opportunity to manage the entire account. I accepted but was frustrated to have bits of a portfolio down significantly (if a portfolio drops 50 percent, it needs to double to get even). We immediately changed our client written investment advisory agreement/contract to reassure clients and help them understand that even though stocks, bonds and interest rates may fluctuate – even as much as they did in 1987 – it is crucial to stay the course, and remain patient and understanding.

I am forever grateful for that young client and the conversation about "risk tolerance". "Risk tolerance" needs to be accurate, otherwise fear in investing – i.e., selling low and buying high – can severely damage the value of your portfolio.

The current market reminds me of 1987. Last year, most investors were very complacent and held overvalued investments, especially real estate and banking shares. Most advisers and

investors were bullish and expected markets to keep rising. Similarly, in the summer of 1987, just before the October crash, adviser bullishness peaked at 46 percent. Then after that crash, 39 percent forecast declining prices – just before the stock market ran up 19 percent (see chart on page 1).

This has been a long and arduous period for FIM Group and our clients. I cannot remember a time where we have had our conviction, patience and discipline tested so completely. History shows, however, that the seeds of profits are sown in periods like these and while others are "panic selling" we are scooping up great valued investment bargains.

I have run a few marathons in my life, and in each one I wondered if I would be able to finish; you put one foot in front of the other when those thoughts come in your head, you stick it out, even though the going gets tough. Investing is like a marathon - you need to be flexible and aware, but most of all you need to be patient and disciplined, and stick with the strategy.

Our strategy embraces the facts that markets are cyclical. We are long-term investors, we manage money for clients that are retired and wish to stay retired, and people who want to accumulate their wealth for long-term goals. We are not short-term market timers, hot "idea of the day" speculators or short-term CD owners.

I know that when running uphill in a marathon it feels like the top will never come, but eventually we make it there and get to relax a bit on the downhill. It has been uphill, into the wind, with horizontal rain pelting our face in the investing world over the past months. We have been in environments like this before and the chart on page 4 illustrates this fact well. It shows that in the last 10 years we have had similar periods.

ROAD TO RECOVERY ... continued from page 2

In my writing and speeches on investing I often chat that "volatility is the side effect to good long term performance". The chart on this page illustrates the rationale to a long-term strategy and why our clients have been well rewarded by staying the course. It is titled '*FIM Group Diversified Long-Term vs. Short-Term Strategies*'. History shows that this is a time to be a long-term investor. FIM Group investments are priced to give great current and future performance from dividends, interest income and growth.

The question we get most often today from clients is "When will this end?" There is only one answer; we know it will end. Nevertheless, it will end when people start looking to the future, are enticed by the great prices of investments and logic replaces emotions, as it always does eventually.

History shows investments will recover and we will forget about the uphill battle. When exactly? What date? I don't know. I do know that, for the clients who have lost sleep over this latest investing marathon, we might need to adjust the risk tolerance on their portfolios to make them more conservative for the next cycle. For those who are excited by the current opportunities, we can chat about raising your risk tolerance a bit, too. I can think of only one time when I felt as much confidence in the fact that our investments were priced for better future investment performance, we were very well rewarded then, and history shows that we will again. **F**

**FIM Group Diversified Long-Term vs. Short-Term Strategies**

Average Annual Total Returns (periods ending 12/31/07)	5 Year	10 Year
FIM Group Growth Composite	17.02%	10.21%
FIM Group Balanced Composite	13.38%	9.29%
FIM Group Balanced Conservative Composite	10.52%	8.39%
FIM Group Yield Income Composite	9.67%	8.33%
<b>Long-Term Strategies</b>		
S&P 500	12.83%	5.91%
NASDAQ Composite Index	14.71%	5.38%
Morgan Stanley Capital International (MSCI) World Index	16.15%	5.91%
CSFB/Tremont Hedge Fund Multi-Strategy Index	10.90%	9.43%
Lipper Global Flexible Portfolio Category	16.11%	10.19%
Morningstar Conservative Allocation Category	7.13%	4.91%
Morningstar Moderate Allocation Category	10.24%	5.99%
Morningstar World Allocation Category	15.79%	10.29%
Morningstar Target Date 2015 - 2029 Category	10.45%	5.53%
<b>Short-Term Strategies</b>		
Morningstar World Bond Category	6.39%	5.65%
Citigroup 3-month Treasury Bill Index	2.95%	3.62%
Lehman Global Aggregate Bond Index	6.51%	6.09%
Morningstar Inflation-Protected Bond Category	5.16%	6.42%
Morningstar Target Date 2000 - 2014 Category	7.33%	5.12%

\* Source: FIM Group 2008 Investment Guide

ROAD TO RECOVERY ... continued from page 3

Month-to-month decline in FIM Group portfolios and subsequent time to recover.

Naturally the future is unknown.

FIM Group Portfolio	Period Start	Period End	Decline %	Length in Months	Worst Month	Decline %	Recovery Time in Months
Growth	4/30/1998	8/31/1998	-14.43	4	Aug-98	-9.83	9
	8/31/2000	12/31/2000	-15.81	4	Nov-00	-9.13	5
	5/31/2002	3/31/2003	-16.68	10	Jul-02	-6.87	4
	7/31/2007	7/31/2008*	-18.91	—	—	—	—
Balanced	4/30/1998	8/31/1998	-12.14	4	Aug-98	-8.33	8
	8/31/2000	11/30/2000	-11.20	3	Nov-00	-6.51	2
	5/31/2002	9/30/2002	-12.12	4	Jul-02	-5.85	9
	7/31/2007	7/31/2008*	-15.42	—	—	—	—
Balanced Conservative	4/30/1998	8/31/1998	-9.71	4	Aug-98	-6.37	8
	8/31/2000	11/30/2000	-7.90	3	Nov-00	-4.44	2
	5/31/2002	10/31/2002	-9.66	5	Jul-02	-4.85	7
	3/31/2004	6/30/2004	-5.35	3	Apr-04	-4.84	4
	7/31/2007	7/31/2008*	-8.47	—	—	—	—
Yield Income	4/30/1998	8/31/1998	-7.86	4	Aug-98	5	8
	8/31/1999	11/30/1999	-5.19	3	Nov-99	-1.97	4
	8/31/2000	11/30/2000	-5.49	3	Nov-00	-3.34	2
	5/31/2002	10/31/2002	-7.35	5	Jun-02	-2.08	6
	3/31/2004	6/30/2004	-6.15	3	Apr-04	-5.52	4
	5/31/2008	7/31/2008*	-7.83	—	—	—	—

\* Note: 2008 statistics are through July 31, 2008, and the downslide could potentially continue.

See *Investing Without Borders* – 2008 FIM Group Investing Guide for annual performance results, summarized on page 8.

## FIM Group Mailbox



by Zach Liggett

The barrage of negative economic headlines and weak short-term investment performance has generated an understandable increase in client concerns. Here is a typical interaction that covers some of the more frequent questions we have been

answering of late. As always, please feel free to call any of our team members should you have concerns about your portfolio.

**Q.) I understand that most investment markets are down this year and that other money**

**managers, including legends like Warren Buffett (Berkshire Hathaway) and Bill Miller (Legg Mason), are also suffering. I thought that FIM Group's active management would better navigate my portfolio through these difficult markets. Why is my portfolio down this year?**

Simply put, our portfolios are down because we have chosen to stay invested in our diversified portfolio of securities at a time when fear has become the dominant factor in many markets. This fear has forced some investors to abandon their long-term plans and run for the exits.

*continued on page 5*

MAILBOX ... continued from page 4

Panic selling has negatively impacted transaction prices, which in turn are reflected in the daily market values of our portfolio values. In particular, we own companies not only in the United States, where market sentiment and performance is weak so far this year, but also abroad, where in most cases sentiment and performance has been even worse.

***Q.) If sentiment is this lousy, why have you stayed so fully invested?***

Trying to predict short-term twists and turns in market sentiment is virtually impossible. We spend the majority of our time analyzing shifts in a company's fundamental outlook and comparing that to current market prices. The cheaper the market price versus our estimate of fundamental value, the bigger the bargain and the more we want to own it.

Our focus on fundamental value essentially boils down to an analysis of the stability and growth potential of a company's future cash flow. We analyze many factors, including competitive position, industry growth potential and financial strength. Presently, despite the current slowdown phase in the global macro-economy, we feel very good about the fundamental strength of the majority of our portfolio investments. As such, our portfolios are nearly fully invested, as we firmly believe that over time market sentiment will normalize, and prices will eventually reflect our fundamental value estimates.

***Q.) Economic headlines seem to be getting worse. When is the economy going to get better?***

Economic data, by its nature, is backward-looking. We can analyze the past and make guesses about the future, but that is all they are – guesses. The good news is that recessions typically last less than a year, and most

of the data we watch (including employment, industrial production, personal income and retail sales) seem to have turned south at the beginning of this year. Therefore, we are likely already more than halfway through this recession (even though any recession will probably not be officially announced until the end of the year). Household debt and home inventories remain two indicators of many we are watching for signs of a recovery. When either begins to improve, we would expect market sentiment to become significantly less depressed.

***Q.) What are you doing to ultimately recover these losses and generate gains for my portfolio?***

We constantly test each security in our portfolio for changes in its fundamental value. When we find that the long-term outlook no longer justifies our position, we sell (in some cases capturing a tax loss for taxable accounts).

We are adding to our highest conviction holdings as other investors are forced to sell them. To do so, in some cases we are selling holdings judged to offer less risk-adjusted opportunity. These decisions are made as part of our team's daily review of portfolio positions. During times of fear like this it should be understood that portfolio changes may occur more frequently as we squeeze out lower-conviction holdings with higher-conviction ones.

We are placing a greater emphasis on stocks with sustainable, above-market dividend yields. We believe that if we remain in an economic downturn, and if investor sentiment remains poor, solid dividend payers will be very important for our total return objectives.

***Q.) Why not just sell my stocks and bonds and hold cash until things stabilize a bit?***

MAILBOX ... continued from page 5

After seeing our portfolios drop in market value so far this year, the natural urge to join the herd and run to the sidelines is understandable. Our experience and training, however, guides us to keep a long-term perspective and stay with our portfolio investments when the fundamentals remain sound. After all, if the fundamentals are sound, why sell if you don't have to? Most of us wouldn't sell our homes or our businesses when prices are as visibly distressed as they are now, so why do so with our stock and bond portfolios?

***Q.) Why are you investing in financial and consumer discretionary stocks when it is so clear that we are in a recession?***

We believe that the financial sector has been indiscriminately sold off. This has occurred despite the fact that many financial sub-sectors, including U.S. and foreign insurance companies and investment management companies, have very little direct exposure to the problems plaguing U.S. mortgage lenders and investment banks. Where we do have U.S. bank exposure, we have invested primarily in corporate debt and preferred stock holdings, whose prices we believe already reflect a worst-case scenario.

On the consumer discretionary front, we are attracted by not only historically low valuations, but as mentioned in last month's Investment Committee brief, the sector's historically low weighting in the overall market. We are not discouraged by what will likely be tough sledding in the near-term for earnings growth in this area, but instead look at how current prices compare to the long-term cash-flow generation prospects for these companies. We believe that now is the time to snap up great franchises in the consumer discretionary space at tremendous discounts to long-term fundamental value.

***Q.) How do you plan to take advantage of fear in the market when I am already nearly fully invested?***

When cash levels are low (as they are in many of our portfolios today), we take more time to rank each security held in our portfolios by level of conviction. In taxable accounts, this ranking process includes a careful consideration of both realized and unrealized gains and losses. To make room for our highest conviction buy ideas, we sell our lower conviction investments. Where possible, we harvest tax losses in taxable accounts.

***Q.) Some of my investments are now trading at just a fraction of my average cost. How will I ever recoup this value?***

For our highest conviction securities, we are reducing average cost by adding to our positions opportunistically. In a handful of cases, we acknowledge that the investment does not merit further capital and either sell immediately or hold (when we assess further downside risk to be minimal) until we can achieve a better selling price. As mentioned above, we believe that the majority of our holdings trade at a significant discount to their fundamental values and will recover their lost market value as sentiment improves. In addition, our shift to greater dividend payers will also enhance total return over time.

***Q.) Anything else to convince me that your team is doing the right things for the long-term protection and growth of my money?***

A very important concept to get across is that during times like this we want to avoid being forced sellers. Pressures to join the herd and abandon long-term plans naturally grow during times of fear like this and are compounded by daily media reminders of how "bad things are" and daily portfolio appraisals that reflect the sentiment in the market. Our investment team is working hard to not only avoid the behavior of the herd, but also to hone in on great opportunities presented by the stampede. As noted above, we feel very confident that the fundamental value in our portfolio companies

MAILBOX ... continued from page 6

ultimately be recognized as the market sentiment reverts to more normal levels. In the meantime, we have shifted to a greater emphasis on solid dividend-paying investments that will provide real cash flow for our portfolios. Each member of our team invests in the same strate-

gies right alongside our clients, and although we, too, are unhappy about this year's performance so far, we feel very confident that the actions we are taking today will bear fruit for our portfolios in the future. **F**

## FIM Group News



**Welcome Linda Barcheski to our Hawaii Office**

Linda Barcheski grew up in Seattle and attended Washington State University. After college, she worked for Westin Hotels in Seattle and shortly thereafter

was transferred to open their first Maui hotel. Linda met and married Randy, a Hawaii-born resident. Linda has two daughters, Sasha and Kristen, both currently attending college. In June 2008, Linda joined FIM Group in Client Services. Her experience in administration, client services and division coordinator make her an excellent addition to our team.

**Ask the Portfolio Manager**

**Ask the PMs:**

*Have questions about: holdings, performance, market volatility?*



*Click here to post your questions.*

A new addition to [www.fimg.net](http://www.fimg.net) is the "Ask the Portfolio Manager" link. We encourage clients to visit the FIM Group website and submit questions to the PM team. We will either answer them individually, in our newsletter or through a webcast.

**Quote**

"You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets."

- Peter Lynch

**The Quiz**

From the October Crash of 1929, how many years later did The Dow reach a new high?

- A. 36 years
- B. 18 years
- C. 10 years
- D. 25 years

*Answer at [www.fimg.net](http://www.fimg.net)*

## Disclosure

Performance results reflect the deduction of advisory fees. Portfolios managed by the firm can experience losses, as well as profits. Therefore, the figures shown should not be considered as a guarantee of future gains or as a limitation on potential loss. The investment advisory fees are disclosed in Part II of Form ADV. The accounts used in these calculations were entered into the calculations when the account value reached \$150,000. The account stayed in the calculations until the account value dropped below \$125,000. Accounts reentered calculations when the value again reached \$150,000. Performance returns were time-weighted monthly, and all trading commissions and management fees were deducted when calculating the returns. All portfolios had dividends and other earnings reinvested. The portfolios selected were categorized by objective based upon the risk tolerance category expressed by a client. The portfolios include all discretionary accounts. The accounts used also did not include unmanaged assets, annuities or limited partnerships in the calculations. Clients having portfolios containing tax, client imposed or other restrictions would have had higher or lower returns than those expressed above. The performance data shown above represents the past performance of the firm's different risk tolerances. These figures have not been audited or otherwise reviewed by an accountant or third party. Also, this data presentation does not conform to the Association for Investment Management and Research Performance Presentation Standards. During the periods covered, other advisory firms have joined FIM Group. The performance of accounts brought under FIM Group's management are included in FIM Group performance beginning in the first full quarter after which those portfolios have been fully converted to FIM Group selected securities. Any questions regarding the compilation or composition of this data may be brought to the attention of FIM Group at 800-632-5528, 888-243-8220, or 888-33-TRUST. Portfolios are managed by the FIM Group Portfolio Management Team. Paul Sutherland has been the Chief Investment Officer and Lead Portfolio Manager since 1984. FIM Group Portfolios represents a mix of global equities, global fixed income, and cash. The main difference between the portfolios can be attributed to the distribution of holdings within a portfolio based on risk tolerance.

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Performance data quoted represents past performance.

Past performance does not guarantee future results. All performance assumes reinvestment of dividends and capital gains. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data current to the most recent month-end may be obtained by calling: 231.929.4500.

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