

MARKETPOINT



perform terribly—those are part of investing. If we see problems we do our best to avoid them, but we cannot predict or time market moves.

Sometimes, however, the financial press can be a good contrary indicator: when they are euphoric, it's time to be cautious; when they are howling about the dire state of the world, it's time to be constructive. During this time when the media is doing its best to convince us that the end of the world is at hand, one can't lose sight of positive events

because these factors will ultimately impact the markets. While there are indeed many continuing structural and cyclical challenges facing the U.S. economy and investors, here are some data points that favor global economic activity and stock investments:

- Mark-to-market accounting rules are being revisited by the Financial Accounting Standards Board. Restructuring these rules could eliminate the need for banks to raise additional capital to meet adequacy ratios. This would be a big step toward getting credit to flow back into the economy.
- The Baltic Dry Index, a leading indicator of global trade, has risen (albeit off a super-low base).
- Rising crude and copper prices signal an impending firming of global GDP (see graph on page 2).
- The upward sloping yield curve also signals economic growth ahead and enables banks to make healthy profits.
- Huge flows into CDs and bank deposits (from risk aversion) should be re-lent into the economy by the banks and ultimately bid up asset prices.
- In this low interest-rate, low inflation environment, many stocks appear super-cheap and the indiscriminate/panic selling phase appears to be over.
- The current strong dollar is good for the U.S. share of global wealth and allows dollar-based investors to acquire valuable foreign assets on the cheap. However, a weaker dollar will signal liquidity is returning (something to watch for).

TO COUNTER THE NONSTOP ECONOMIC negativity reported by the irrepressible media, we thought this may be an appropriate time to shed light on some of the more positive current developments. We have no idea what stocks will do over the next week, month or year, but investors should be aware of some encouraging signals.

At the risk of sounding cliché, stocks do tend to generate fantastic returns over long periods of time—far better returns than bonds and real estate. This is especially true following big market declines and periods of high risk aversion, as at present. It is easy to lose sight of this fact after the experience of the last 9 months, but there will always be periods where stocks

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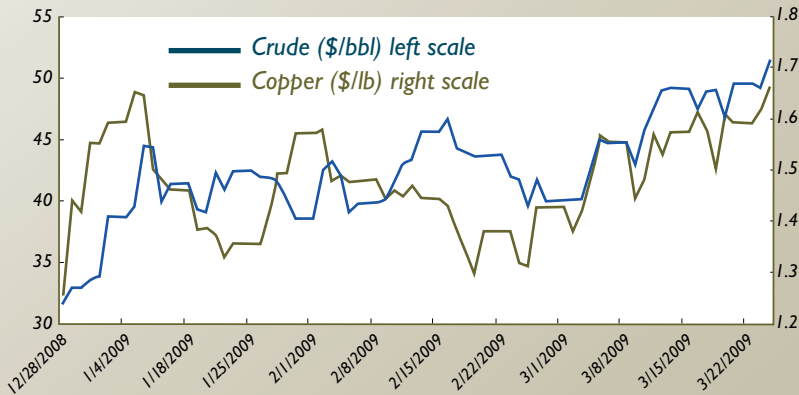


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Prices of Crude Oil and Copper: December 2008 – March 2009

Source: Bloomberg



- Market volatility is much lower now than during last year's massive sell-off.
- Investor sentiment, a reliable contrary indicator, is at multi-year lows. Hopelessness is in vogue.
- Low energy prices help offset the higher cost of capital (from tighter lending standards), especially in the emerging markets.
- Global fiscal stimulus will be significant over the next few years given bailouts and spending packages.
- Bond spreads are much lower than at their peak in November 2008.
- Higher gold prices signal that the reflation effort is gaining some traction.

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We have been reporting on the structural problems and excesses of Wall Street banks for years and had an inkling that it might end badly for a number of institutions. We did not forecast that the excesses would bring the financial system to the brink of collapse (which, in hindsight, was avoidable if the obvious issues were handled properly and in a timely manner). The size of the problem (we estimate around \$10 trillion of overvaluation of U.S. residential housing in mid-2007), while large, can be absorbed by a \$54 trillion global economy¹ and by U.S. Household wealth (estimated at \$64 trillion in mid-2007²). Since a portion of this overvaluation comes out of financial institutions' equity capital—as they lent against properties that have since declined—there is a multiplier effect: the write-down of securities and loans tied to these properties curtails lending by a factor of 8 to 10. But the write-down cycle will end and the hole in the stockholder equity should be filled by governments and new private capital somehow, somehow—which will precede credit markets normalizing.

Those who took the downside in equities and then converted to cash in recent months now risk the double whammy of having a zero return on a significant portion of their investment portfolio when gasoline prices rebound and food prices increase significantly again. Essentially, the opportunity cost of being in cash will likely be large when investments trade up to more reasonable prices.

We feel strongly that the worst is behind us in terms of portfolio declines and that, while not complete, much of the needed economic rebalancing is underway. Moreover, we are concerned that the size of the monetary stimulus will lead to inflation and a weaker dollar, but we don't know *when* that will happen. That the cumulative returns on Treasuries exceeded stocks over the last 13 years either means that capitalism is dead (which we do not believe) or that Treasuries are way too expensive and/or that stocks are way too cheap.

While we do not know what returns will be over the next week, month or year, we are trying to see the forest through the trees and position portfolios to capitalize on the short-termism of others and to hedge the risks that can negatively affect our clients' living standards. We believe strongly that the long-term trends and thesis that form the foundation of our investment strategy have not been repealed by the experience of the last nine months. To the contrary, the experience has created opportunity. ■

¹ Source: The Central Intelligence Agency World Fact Book

² Federal Reserve data



INVESTMENT COMMITTEE PERSPECTIVE

WHY PRUDENT INVESTING IN BONDS MAKES MORE SENSE THAN CASH

Over the past 6 months many investors have sought refuge from declining asset prices. They have liquidated long-term assets and reinvested the proceeds into the perceived safe havens of Treasuries, CDs and money markets—creating an asset bubble in these instruments. These investors are accepting meager returns in exchange for a feeling of safety. These safe havens, however, present their own set of risks—perhaps not principal risk, but certainly purchasing power risk, especially with yields that are now close to zero.

As such, for clients who do not want a lot of near-term volatility or principal risk, a far better strategy may be to strategically invest these funds in bonds. In addition, while they are usually priced efficiently, we believe many fixed income sectors are presently underpriced. Without a doubt, we feel they currently offer a much better risk/return trade-off than cash.

We are focused on 3 major areas to take advantage of current markets:

- 1. High grade, short duration (less than 3 years) corporate bonds:** Spreads between corporate bonds and Treasury securities are at record levels (see chart below). When (not if) credit markets normalize, these securities should maintain their value—even in the face of rising interest rates—due to a reversion back to more normal spread levels. In fact, there is the potential for gains that CDs and cash do not have.

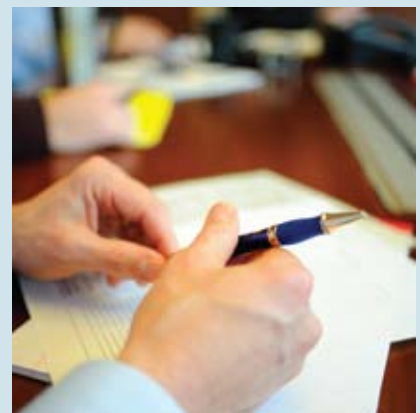
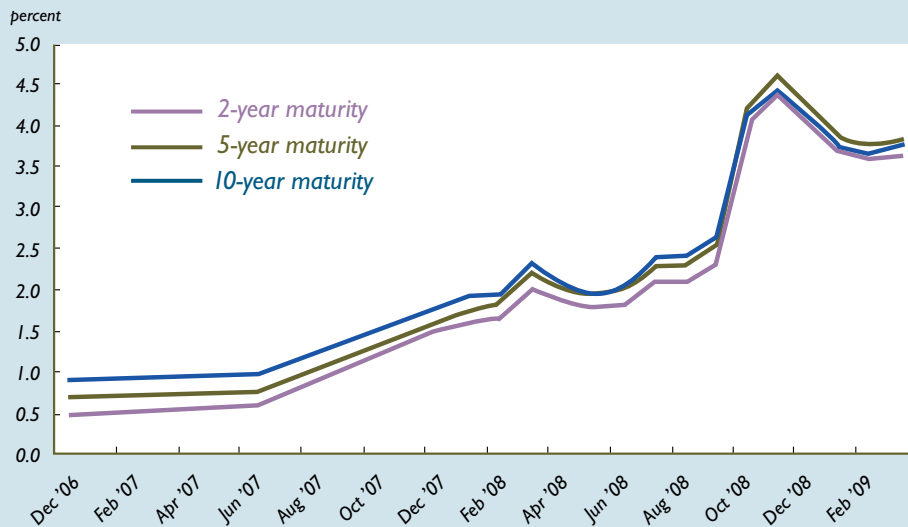
- 2. Inflation protected securities, including U.S. and foreign government TIPS:** While there are currently significant deflationary forces at work, the sheer magnitude of money being printed to stimulate the economy and to put a floor on asset prices to shore up banks' balance sheets can ultimately be highly inflationary.
- 3. Non U.S. dollar investments:** The U.S. dollar has undergone a fierce upward revaluation against foreign currencies in the recent massive flight to quality and deleveraging process. Once demand and the economy are perceived to be on more solid ground and liquidity starts flowing, the U.S. dollar should revalue itself downward vis-à-vis politically and fiscally sound countries with natural resources (i.e., Canada and Australia).

By focusing on the aforementioned sectors, we believe our fixed income portfolios are positioned to preserve principal while protecting against rising interest rates and inflation pressures—all this while currently yielding in the 4–6% range with some holding period variability. ■

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Spreads of A-Rated Corporate Bonds (versus Treasuries): December 2006–March 2009

Source: Bloomberg



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OBERMEYER UPDATE

AT OBERMEYER, OUR INVESTMENT ADVICE is tailored to the individual—it is not a cookie cutter approach that assumes all people have the same goals, risk tolerance and investment temperament.

Our starting point is to determine what asset allocation makes sense for each client and each account. This is instrumental in both the initial portfolio construction and in the ongoing account management. Investing in longer-term assets (i.e., equities) is necessary to achieve capital appreciation, but requires patience and a multi-year horizon. The inclusion of fixed income securities reduces the volatility of portfolios, facilitates distributions, and can serve as a liquidity cushion during difficult markets. We are focused on targeting the appropriate balance of these asset classes and on making smart, calculated investments within their respective allocations.

It is important to remember that there is no “right answer” or “perfect solution” in investing; it is a highly personal experience. An investment strategy should also evolve over time, reflecting changes in the general market as well as in one’s life.

We need our clients’ partnership to ensure we are able to do the best job possible. If personal circumstances have changed, or if the ongoing volatility is causing undue stress, please let us know. We can’t make changes in a vacuum, and believe there is no substitute for individual reviews or discussions. Our team is available to meet in person or on the phone.

The recent credit crisis has shaken even the most seasoned investors, with people seeking thoughtful, objective advice to help them navigate the years ahead. Recently, we have had many conversations with investors who are seeking help as they no longer desire to manage for themselves or don’t believe their current adviser is meeting their needs. If you have any friends or family members who would benefit from our help and perspective, we would be happy to meet with them. Please contact us and we can jointly determine how best to proceed. ■

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Past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment will be suitable for an existing or prospective client’s investment portfolio. Therefore, no existing or prospective client should assume that future performance of any specific investment or investment strategy (including the investments or investment strategies recommended herein) will be profitable or equal any historical performance levels.

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