



AS WE CLOSE THE FINAL CHAPTER ON 2008, investors are feeling battered and bruised by this year's market activity. The word "unprecedented" lost its emphasis as it was used repeatedly to describe the last 12 months' drubbing. Most market participants—large and small—have significantly lower portfolio values, causing everyone to reevaluate their risk appetite and long-term goals.

While we can rehash the market's ups and downs, we feel energy is better spent looking forward. Those able to sift through the rubble and identify the values and themes that will shape

the market over the coming years/decades will likely be rewarded with much greater real wealth. We can't tell you when this will happen, but history has shown that intelligent, calculated risks earn healthy returns in the long run. As we have often said, investing is like looking at the ocean—the vast majority fixate on the ripples in the water; a few on the waves, but it is the tides on which fortunes are made and lost.

#### We have several strong convictions:

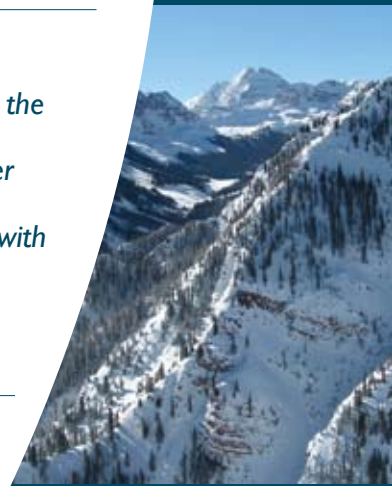
- 1 The world will not enter a severe depression. Governments everywhere are committed to injecting huge stimulus (both Keynesian by buying bad assets and Monetarist by increasing the money supply) to prevent this outcome.
- 2 With this stimulus will come inflation, eventually. The U.S. and other governments have already committed \$8.5 trillion to invest in, guarantee, or loan to financial enterprises.<sup>1</sup> And there will likely be more commitments to come.
- 3 Banks will lend again. Many have already been or are in the midst of being recapitalized, and there is a tendency to hold off making loans and to hold T-bills until the turn of the New Year as they want to show their balance sheets in the most pristine and liquid light. The commercial pressure to earn the huge net interest margins available in lending will bring this liquidity back into the economy.
- 4 We are currently in a leadership and communication vacuum after a period of ad hoc government interventions in reaction to market gyrations, insolvent lending institutions and revelations of large-scale frauds. While the current extreme risk-aversion is understandable, it will not persist forever.
- 5 Infrastructure spending will increase—both here and abroad.
- 6 The enormous populations of the emerging markets will keep striving to improve their living standards.

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“*Those able to sift through the rubble and identify the values and themes that will shape the market over the coming years/decades will likely be rewarded with much greater real wealth.*”

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<sup>1</sup> Source: Guild Investment Market Commentary



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- Looking to 2009 and Beyond
- Fearing Inflation—Not Deflation
- When Was Your Last Annual Review?

“Wealth preservation is a goal, but so is earning real returns by taking compensated risks.”



- 7 The rush to U.S. Treasuries has created a bubble that will collapse as risk aversion abates. These investors will look for reward elsewhere as they begin to understand how governments are leveraging their own balance sheets and as credit begins to flow again.
- 8 Stocks in high-quality, cyclical companies are trading at extremely cheap valuations—and in certain cases, at a discount to the cash on their books. Many investments are priced for doom-and-gloom and patient capital will be rewarded in advance of an economic recovery. (We are assuming the world will not be in recession forever.)
- 9 Commodities are not dead. They are currently at mid-1970s levels in nominal prices, and once evidence of global economic health surfaces, the rally in these sectors will be significant.
- 10 If something seems too good to be true, it definitely is. Madoff's scheme reminded investors that there is no magic bullet, no secret formula, and no substitute for hard work, thoroughness and patience.
- 11 Market volatility will continue to be high, and there will be moments of both panic and euphoria in the future. To us, this is just markets doing what they do... not a reason to invest or not invest. And *finally...*
- 12 The principles of investing still apply.

Our firm remains committed to navigating global markets to find attractively priced investments for our clients. But attractively priced also means taking on market exposure. Wealth preservation is a goal, but so is earning real returns by taking compensated

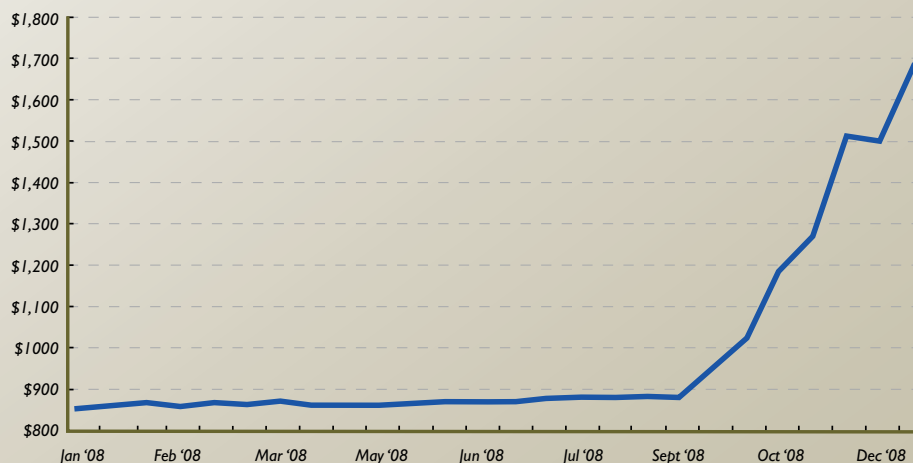
risks. Our investment approach, grounded in extensive research, is designed to try to avoid permanent losses of capital. Because we have to make judgments based on imperfect, backward-looking, outdated information to make extrapolations into an uncertain future, we won't always get it right. The key is to be humble, evaluate opportunities with clear-headed focus, exercise patience and for clients to have the right asset allocation (i.e., enough in cash and bonds) to weather difficult environments.

The biggest mistake is to project a continuation of 2008's events decades into the future and not take any strategic risks. While we can't predict the market, we believe that our core principles of global value investing will serve our clients well. ■

### Adjusted Monetary Base

Source: Federal Reserves Bank of St. Louis

Billions of Dollars



# MARKET POINT

**IN OUR PRACTICE**, we make a clear distinction between the economy and investment markets. Through its pricing mechanism, investment markets project forward its best assessment of what the future will look like. The economy, by contrast, is what actually occurs. This past year's market action implies global economic hardship far into the future; we believe this pessimism is likely overstated.

Many say that "in panics correlations go to one." In the great margin call of 2008, no risk-asset was spared from heavy selling. Real estate, gold, commodities, foreign stocks, high yield bonds, private equity, non-dollar currencies, high-quality foreign bonds, and U.S. stocks were smashed as investors rushed for the exits to hoard Treasury bonds and cash. Diversification, quality and patience—the basic tenets of investing—did not protect.

In hindsight, it is pretty clear what happened. Since investment markets are tied to the ebb and flow of credit, 2008 was a year during which credit ebbed. Credit *had* to ebb after many years of excess, making geniuses out of too many people and creating a belief system to which many banks and Wall Street firms leveraged themselves. That belief system was based around the idea that asset prices, namely real estate, will always continue to rise—allowing for consumption through equity withdrawal and entitling an ever-improving lifestyle.

The difficulty with rising asset prices is that they beget increased leverage: the confidence and euphoria that come with bullish times lead to increased consumption—and people often withdraw equity from their assets and replace it with debt to fund this consumption. The leverage becomes unsustainably high and asset prices have to reset lower.

While the resetting process does impact economies, we feel strongly that the \$30 trillion in global stock market values expunged this past year, along with all the lost value in real estate, overstates the present value of the future contraction in global GDPs.

We are skeptical of Treasury investors' current view that we are staring into the abyss of deflationary collapse in the global economy. Is there too much capacity and overinvestment in certain industries? Yes, but the overhang can be worked off. Moreover, there has been no disruption in global trade, brilliant technological innovations lie ahead, and living standards are improving globally.



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**“Don’t worry, this land is good.  
Just don’t go crazy with the leverage.”**

Besides, what better way of combating deflation than by injecting a healthy dose of inflation—the government's default remedy! To do this, authorities have set up lending facilities, reduced rates to near zero, swapped Treasuries for toxic assets and increased the money supply. They are counteracting the withdrawal of private credit by substituting public credit because they know that to relieve the debtor class means enabling it to pay back its loans with cheaper dollars; in other words, to engineer inflation.

To implement its plan, the government becomes the world's largest hedge fund by entering "the carry trade"—borrowing cheap to invest in other assets. In this case, it will invest in assets that it believes will get credit to start flowing again, like mortgage-backed securities. Since it can issue T-bills at .01%, it changes the characteristics of Treasuries from offering investors a risk-free return to offering return-free risk!

At the moment, the press is fixated on the damage and dislocation wreaked by this year's destruction of wealth. However, with the gold price rising, corporate spreads tightening, LIBOR declining, the TED spread back in normal range, gasoline bottoming at \$1.50, and improving housing affordability, there is evidence that the reflation effort is working. As such, while the economy will likely further correct, we feel that deflation will be a story of the past, and that those who sought refuge in cash after taking the hit in their investment portfolios are at risk of compounding their problem. The institution of credit—while still remorseful of its promiscuous years—is gathering strength for the next cycle. ■

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# OBERMEYER UPDATES

## TAX TIME

As we all know, April 15th is right around the corner. Although we have included year-end tax information with our fourth-quarter reports, we understand that questions always arise during filing time. Please contact us and we can try to respond to any of your or your accountant's requests for information. We can also provide income and capital gain/ losses updates during the course of the year to aid in calculating quarterly estimates.

## VALUE OF UPDATE MEETINGS/ ANNUAL REVIEWS

We heard from a few clients that they were concerned about contacting us this past year because they didn't want to distract us during tough markets. We are never too busy for our clients, and welcome any questions or concerns. Please call, email or stop by the office. If you have time, we recommend one-on-one discussions or conference calls at least annually to review your individual financial situation. There is no substitute for these detailed reviews where we can discuss your goals and your Obermeyer accounts. We are also happy to review your other assets and accounts to provide our opinion on your complete financial situation.

## UPGRADING CLIENT COMMUNICATIONS

We are working on new communication channels to provide our clients with more frequent market updates. This past year's client conference calls were well received, and we intend to conduct them every quarter going forward. We are also committed to updating our electronic communications and plan on posting client communications on our website in early 2009.

### *Mark your calendars:*

The next client conference call is scheduled for February 19th, 2009.

As a reminder, we prefer to send out our invitations electronically. Please contact us with your current email address information, or to let us know if you would rather be notified by regular mail or phone. ■

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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.

Certain portions of our newsletter may contain discussions of recommendations as of a specific prior date. Due to various factors, including changing market conditions, such discussions may no longer be reflective of current positions or recommendations. Information included herein should not be construed as the receipt of, or a substitute for, personalized individual advice. A copy of our current written disclosure statement discussing our business operations, services, and fees is available upon written request.

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