



Wealth Builder Weekly

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Gaia Wealth Builder Client Weekly Newsletter Feb. 9, 2009

January Performance Notes

This part of the recovery from a bear cycle can be most testing. The optimism of December gave way to realism about a worsening economy and truly dreadful corporate earnings for the 4th quarter. This said, by this writing, the damage has been limited to about a 62% retracement of the gains made since the bottom on Nov 21. But what does all of this Martian mean to us in the real world?

It means that January was the worst January on record - the S&P 500 dropping (8.6%). This being said, our moderate accounts dropped (3.4%) and conservative accounts dropped (4.1%). Given that we have long-term investments, one months' performance is hardly more than a chance move - as mutual funds cannot tweak portfolios to suit each small move. But the astute among you will note that both of our strategies lost less than the averages and, strangely, the conservative option fared worse than the moderate, more aggressive option.

On Losing Less

In a long race, especially one with an index which has outperformed bonds, commodities and real estate over long periods of time, one needs to avoid too much handwringing and handclapping over short-term moves like a month. We do not like our accounts to go down, but take great solace that if we can beat the Index in rising markets (like we did from 2003 through 2007) and in falling markets like 2008, we will emerge in really good shape. Only Bernie Madoff (the crook who ran a Ponzi scheme in our business) could have only 3 losing months out of some 15 years. It just does not happen that all months are gainers or that all years are gainers.

On Moderate Vs Conservative

One of our moderate funds, Ivy Asset Strategy, is almost fully hedged and has been since early November. Clearly those managers expect more downside. Hence, they ended the month pretty flat, while our conservative accounts were more balanced in their allocations. On the face of it, Ivy should be in the conservative side, right? No, because the managers make such bold moves that the long-term performance (measured year over year) shows more fluctuation than we would like for conservative clients.

Hopefully, beating the S&P 500 Index by 50% can be chalked up as a great victory. I see it that way.

Why We Outperformed

No banks. It's that simple. Banks and financials dropped 26% in January, taking the S&P along with them. We won't always get it this right, but we're trying!

Why Just Two Strategies

We used to have an aggressive growth strategy but looked at the very long-term record of aggressive funds and concluded that a more moderate way brought better long-term results, both from a smoothness point of view and from absolute performance.

All of our fund managers have wide latitude of investment choices. We want it that way. They have the highly paid staffs, not us. They can respond to market opportunities and danger far better than we can. But we choose them and we must monitor their performance. This we do!

Prognosis

The world economy was hit by a huge credit hammer in September with the collapse of Lehman Brothers. Almost immediately, the commercial paper (companies fund short-term needs with commercial paper) market froze up. The catalyst was a large money market breaking the buck, having invested a lot in Lehman paper, hung up in the bankruptcy process and unavailable to money fund shareholders desiring redemptions. Then, in a blow to world trade, banks could not trust each other again and the export trade the world over virtually ground to a halt.

We are now experiencing the fallout from the global cardiac arrest in Sept, Oct and Nov. That said, what is stopped quickly can be quickly started, provided that conditions improve. And they have.

In the interim, though, the American consumer woke up and decided that it was time to put on the spending breaks. There was too much negative news - too much uncertainty - to go further out on the credit limb.

And that's where we are today. Companies reported generally dismal 4th quarter news, and their outlooks for this year were not much brighter.

That, folks, is just the recipe needed for a turnaround. You don't get turnarounds when everyone is optimistic. But there are huge dangers ahead. Housing still has not bottomed and now commercial mortgages seem to be in freefall. One hole after another is appearing in the dike.

Thankfully, the Administration has people with several fingers busily at work designing a system to not only plug the holes but to build a stronger dike in the form of regulation.

We may see the bottom of the economy this year, but there are no clear signs of a deceleration of the downturn. The stimulus package will help the world over. But optimism must return before any serious improvement can happen. There are hopeful signs, but we are not sure that our long winter has passed.

This said, capitalism and markets go through these gyrations occasionally. Living through them is usually the best course; the absolutely worst course is to abandon ship at the bottom.

As in 2002, when virtually everyone was negative, we will see a valiant move upward. It serves only to await that moment.

Interestingly, long-term trends do not tend to be broken by depressions, at least in the case of the 30's depression. Japan may be another matter. The long-term economic growth of the U.S. returned quickly to its trend line after the depression. It's almost as if the depression never happened. That said, looking at long-term trend lines is a 20 year proposition - most of us do not have the stomach to ride out years of underperformance like the depression brought.

Still, this one is no ordinary recession, in that fiscal power must be brought to the problem; monetary power (reducing interest rates) is not enough to stem the deflationary tide.

Stay with us and stay tuned. After 5 years of outperformance on the upside, we do not intend to give back very much. Advancing and declining, taking and giving - this is the subject of another essay. Suffice to say that some giveback is part of the investing process. Remember Bernie Madoff. It takes omniscience to sail through long periods without losses. The key thing for us is to lose less than others, that we might have more "firepower" at great buying opportunity - like Nov 21.

Thank you for investing with us.

Jim Pursley

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