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# PORTFOLIO COMMENTARY

FROM THE ALDER FINANCIAL MANAGEMENT TEAM

ISSUED JANUARY,  
2009

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## Looking Forward

As we enter 2009, we want to spend some time looking forward and sharing our investment plans for this year. While it is no secret that we are in the midst of the worst economy in decades, the vast majority of these problems finally appear to be priced into the market. The current market downturn is very painful, but it is important to realize that no matter how bad the economic conditions are today, they will eventually get better. The main question is: when will they get better? If we knew the exact time when the economy will improve our job would be much smoother. Even though we don't know when the economy will recover, we do expect this bear market in stocks to persist for awhile longer.

The real estate and banking problems reeked havoc on the markets last year, and in response to the stress in the stock markets, we began to accumulate cash during the third and fourth quarters of 2008. Cash was one of the only asset classes to post a gain last year, and we made a conscious decision to take advantage of this. Each week, all of the cash in our client accounts is swept into money market funds that earn a modest return. So it is important to understand that the cash in your account is not simply sitting there doing nothing, but in actuality it is earning something. As we watched the market news worsen in the second half of 2008, we deliberately chose to avoid stocks and increase cash (i.e. money market funds) because cash provided a virtually risk-free holding place and a positive return as we waited for a calmer environment and better opportunities.

We now feel the worst is over and are seeing some opportunities to deploy these cash reserves. Though we believe unfavorable equity conditions will persist through most of 2009, the recent easing in the credit markets should translate into improved performance in the general bond markets. Selected fixed income yields are very enticing, and we plan to use the cash we have amassed in the coming recent months to take advantage of these yields. Until the economy starts to turn, hopefully late this year, we believe that the stock market will stay within a trading range, so we do not envision meaningfully adding to our equity allocation this year. Instead, we plan to focus our attention on dividends and interest in the near term in order to deliver performance through consistent cash flow.

## Income Opportunities in the Coming Year:

### Increase Non-government Guaranteed Bonds

One of the areas that we have seen investment opportunities emerge over the last few months is in the non-government guaranteed debt market. In general the credit markets have quickly moved from an attitude that risk was worth nothing to the other extreme in which the required yield to accept risk is off the charts. The result is that any debt instrument that carries any degree of risk is being priced at excessively low levels, which in turn drive the cash flow yield up. In extreme cases certain asset-backed bonds have no market and forced sellers must take whatever price they can get. This presents a unique opportunity for us to acquire high-yielding bonds at attractive prices.

## Increase Municipal Bonds

A huge wave of credit downgrades has hit the municipal bond market due to the rating cuts of the primary bond insurance firms. For decades small issuers in the municipal bond market have depended on bond insurance to carry triple-A ratings on their issues. Last year huge losses in the CDS market hit those same insurers (MBIA, AMBAC and Fitch) which in turn caused them to have their own credit downgraded. For their municipal customers, this meant a loss of the AAA rating the bonds carried. Prices on those issues dropped enough to offer some very attractive taxable-equivalent yields.

## Increase Preferred Stock

Preferred stocks are a quasi-debt instrument. By that we mean that they have characteristics of both common stock and debt. Preferred shares carry a fixed dividend similar to a bond's coupon. Because these payments are subordinated to the senior debt of the issuer, they carry a slightly higher level of risk. In a market such as this where risk is priced high, the yield on these issues can range from 9% to 11%.

## Increase Alternative Fixed Income Funds

For us, this asset class primarily contains funds that are exposed to the high yield corporate markets or are leveraged in some fashion. This market downturn has severely impacted this asset class and has caused share prices to fall dramatically throughout last year. While this type of investment normally has more volatility, it also has a much higher return profile. In the environment we face, we would expect to garner yields in the mid-teens. But because these assets contain more risk, we are careful to maintain a modest allocation of these investment vehicles. The inclusion of this group would greatly depend on the client's risk profile.

## Increase Dividend Yielding Stocks

We will tread lightly in this area. For our least risk-adverse clients we will probably increase our equity exposure in those companies with stable dividend policies. We'll achieve this via investing in exchange traded funds that are designed for maximum dividend yield. We think this current market downturn gives us the opportunity to add some attractive companies at reduced prices and be paid 5% to hold on to them. Historically, rising dividend paying stocks have been an attractive place to put your money because they are an inflation hedge while providing the potential for future capital appreciation.

## Decrease Money Market Funds

Cash has been our safe harbor investment for much of 2008. While this has served us well the yields are quickly falling. Money Market yields are tied to ultra-short lending rates, and with each Fed rate cut those yields decline too. The Fed has now pushed the target Federal Funds rate to near zero. At that level we expect Money Market yields to remain below 0.5% until an economic recovery takes hold. Our goal is to greatly reduce our Money Market balances in the first quarter of this year.

## Summary

We view 2009 as a great opportunity for capturing fixed income securities with high yields that will generate steady income for years to come. Though stocks are an important component of any well-diversified investment strategy, we expect this year to prove sluggish for the stock market and therefore we want to avoid exposing your account to more depressed returns in that market. We look forward to the eventual upswing in the stock markets, but until then we will continue to examine every investment carefully and navigate the current economic conditions with extreme prudence and discrimination.

