
PORTFOLIO COMMENTARY

FROM THE ALDER FINANCIAL MANAGEMENT TEAM

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Is the Glass Half Empty or Half Full?

This is an interesting thought to ponder. By most accounts you would think the glass was completely empty. However, we think the answer is not that simple. Certainly, there is no way to sugar coat the current state of affair of the financial market. The economic news and market reactions have been downright disturbing in many instances. If history is any indicator (and we believe that it is), the night is always darkest before the dawn. Using this logic, the 3rd quarter of this year may very well have been our darkest time. For the health of the market and the economy to improve, a bottoming out process must unfold, which we believe has and continues to occur.

A number of important events occurred in the past quarter that set the stage for the bottoming process. As it became evident that Wall Street and Main Street were joined at the hip, the U.S. government jumped into action. Until last quarter, the governments' effort to stave off the credit crisis focused on actions from the Federal Reserve to provide liquidity to the credit markets. As the situation turned for the worse, the Treasury was forced to bring more ammunition to the fight. They did so by creating various bailout plans for the banking industry. Let us not forget that access to credit and lending is what drives the worlds' economy, neither of which was readily available during a large part of this current crisis. Adding to that problem is the most likely confirmation of a U.S. recession. The Treasury Department and Congress are attempting to remove the rampant fear from the economy by spending money, but with the looming fear of large bank failures the financial markets have gone into disarray. Extensive government spending coupled with financial markets gripped in fear resulted in a deteriorating situation. Fortunately, the governments' measures seem to be helping on some of the more immediate issues, such as bank failure and credit availability. However, only with the passage of time will the longer term issues, such as the depth of our recession, become clearer.

It is because of the gradual improvements in the financial crisis and the governments' willingness to provide relief that prompts us to say the glass seems to be slowly filling up to the half full mark. No one likes the recent downturn, but in free markets it does occur occasionally. At some point market historians will be able to fully analyze what did in fact occur. For us that live in the real world, it is vitally important to focus our attention on what we have done to protect ourselves and what we can do to move forward.

Our Response

Again, with history as our guide, it is very difficult if not impossible to predict with any degree of certainty timing of the inevitable declines in the economy. The best you can expect to do is to make changes in your strategy as a downturn becomes evident. As all of the events from this crisis unfolded, we began to focus our attention on two main points: what can we do now and what can we do later once the crisis has passed? Our initial concern was protection. When the markets decline there are only a few actions you can take: have extra liquidity available, focus on cash flow investments, reduce company specific risk, hedge positions against losses, or sell out. We did not

think it prudent to entertain the idea of selling out, so we considered the other alternatives. In fact, those actions have always been part of how we invest your money. We feel selling out should only be used as a last resort during a market downturn. A market loss does not become permanent until you sell. Moreover, if a position is sold simply out of fear, then you may miss the recovery that inevitably happens in the future. As for the actions we chose to undertake, we think it is most important to focus on the short-run protection positions and benefits they have provided. Following are a few strategies we have pursued in our client accounts.

Liquidity and cash flow

Recently, we have steered our client accounts to contain on average a much larger amount of cash than normal. This cash serves two purposes, which are to act as a cushion on declining values and allow us to buy new assets at cheaper prices. While we have spent a great deal of time talking about cash flow in the last few quarters, it warrants further commentary. The ability to produce cash flow is never more important than during difficult market environments. From an investing standpoint, we find few things are as rewarding as receiving interest and dividend payments during times like these.

Reducing Risk

A great deal of our time this year has been spent on trying to reduce individual company risk. During normal downturns, an individual companies' stock can be very volatile. To reduce that potential volatility, we have started using more products to mimic the overall risk in various markets. This gives us an inexpensive way to achieve market exposure without specific company risk.

Hedging

We began to use various techniques to hedge or protect asset values. There are various financial instruments that will increase in value if the market declines. By introducing that type of position to your portfolio, we can achieve protection in a downward market. The degree to which these hedging instruments were used was a direct result of ones' risk profile. Sometimes they are used to completely hedge a stock market position while other times they are used to profit on the falling market.

Moving forward

As you can see we have been busy trying to mitigate the effects of the current market. It has been challenging to say the least. However, the serious declines we have witnessed appear to be behind us for the time being. There are still plenty of challenges ahead. While we have seen a marked improvement from the market lows, we are still quite a ways from the highs in 2007. In fact it may be some time before we get back to those levels. In the meantime, we will continue to focus on cash flow and protection strategies when necessary. As an investor, we ask you to keep up the faith. We have all faced and survived markets like these in the past and will do so this time. We simply need to be patient and react in intelligent ways to move forward.