



Registered Investment Advisor

## STEIN WHITTINGTON DENIEL INVESTMENT ADVISORS

# Wealth Manager

Jan 09

## SOME HISTORY AND HOW WE VIEW MARKETS NOW

In the early 1920s, the Stock Market experienced a six-year run during which its value increased more than five-fold. On September 3, 1929, market prices peaked at 381.17. Thereafter, during September 1929, the market experienced a 17% decline. Then, on October 24, 1929 - "Black Thursday" - the market decline accelerated as 12.9 million shares changed hands. The sharp declines continued the following Monday and Tuesday during which the markets lost, on successive days, 12.82% and 11.73% with increasing volume. On July 8, 1932, the market reached its lowest close of 41.22 — an 89% decline from the peak. The Stock Market Crash and The Great Depression, which at its height saw nearly 25% of the Nation's work force unemployed, hung on until 1941 when the United States commenced manufacturing gearing up to engage in World War II.

The differences between the markets then and now are substantial. To note just a few: today, we have many "markets" whereas in the 1920s and 1930s there was only the New York Stock Exchange. Today, average trading volume is about 125 times larger and we have large worldwide stock and commodity markets. Today, we have much larger populations and incredible technologies, not available during the Crash. Even with many differences, however, we have to take note that the deep market declines during 2008, were eclipsed only by the Crash of 1929-1932. (see back page).

We see reasons to believe the equity markets have bottomed and likely will increase during 2009. At the least, we believe that downside risk is minimal. Reasons for cautious optimism include: (1) the highly unpopular Bush Administration will be replaced by the extremely popular Obama Administration on January 20th. There should be wide support for the new Administration and for President Obama. (2) Billions of dollars have already been deployed to stimulate the economy and billions more will follow during Obama's first year in office. These dollars should increase liquidity, dispel some of the gloom of

investors and should prevent widespread business failures. (3) Interest rates are extremely low. (4) Most likely there will be some intelligent fiscal policy such as reduced tax rates on businesses and individuals. (5) Record high volatility (which marks market bottoms) has begun to moderate since the end of December, and bad news during the past month was absorbed without major fluctuations, which indicates that bad news has already been priced into the market.

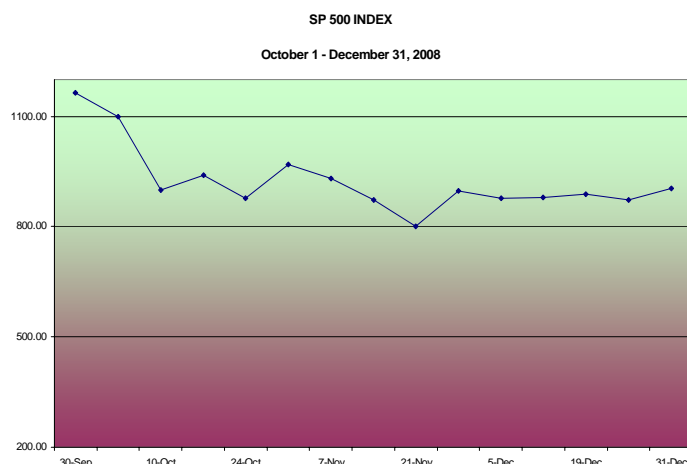
All of these factors give some reason for optimism. Since our "centerpiece" investment strategy is Covered Call Writing, it is also important to note that Covered Call premiums in this market environment are very high by historical standards. For example, when writing Covered Calls on a recent stock or ETF purchase today, we can expect to generate a premium of approximately 2% to 6% on a trade for 5 to 6 weeks. Assuming Covered Call premiums of 3% per month (reasonable in this environment), we can see they provide good incentive to purchase selected equities in the current market environment notwithstanding the abundance of gloomy news and falling profits. In addition, on stocks where we have suffered serious declines and we would write Covered Calls with Strike Prices Out of the Money (not likely to being called away), but still generating cash flow for the portfolios.

Since 1945 there have been about 18 recessions, some of them quite severe. Given the length of past recessions, we should be more than half-way into the current recession. If this is true, by the third quarter of 2009, we believe we can look forward to recovering markets which, by the end of 2009, could see the DOW near 10,000. Moreover, as we believe many of the excesses of the past 15 years or so have painfully abated, this creates an excellent environment to signal a substantial market recovery during 2010 and thereafter.

Nonetheless, we must also express a cautionary note even while sharing with you our views going forward. Experts, acting in good faith, are wrong every day about the direction of equity markets. In addition, events can happen which are unforeseen, including, without limitation, war, disease, famine, natural disasters, etc., which would be quite bearish. Thus, while we believe we owe an obligation to our clients to express our views, we do not possess a "crystal ball" and we may not always be correct in our predictions.

Since our "centerpiece" is Covered Call Writing, it is important to note that Covered Call premiums in this market environment remain very high by historical standards.

## THE QUARTER IN REVIEW



The last quarter of 2008 registered the worst quarterly performance since 1929. Sharp declines were suffered across the board: -19.12% in the DJIA; -22.45% in the S&P500; and -24.61% in the Nasdaq. The major indices also declined significantly for the entire year, as follows: DJIA, -33.84%; S&P500, -38.49%; and the Nasdaq, -40.53%. Despite the fact the last 3 trading days of the year were positive, it is clear the declines sharpened during the month of December.

Much of the bad news — which is pervasive — was discussed in our last two Wealth Manager Newsletters. New data continues to be exceedingly bleak. For example, the index of U.S. manufacturing activity released on January 2, 2009 fell to the lowest levels since June 1980 when the economy was reeling. New purchase orders have declined to the lowest levels since records began more than 60 years ago. Auto and the real estate sales news continued to be dismal.

We find ourselves in a sea of bad financial news. Nevertheless, it appears to be priced in, thus any ray of good news will be greeted enthusiastically by the markets, and there are a lot of reasons (see page 1) to expect some good news could emerge during the next year.

#### A Word About the Bernard Madoff Affair

One of the worst frauds in the history of investing appears to be unraveling in the case of Bernard Madoff who estimates he lost \$50 Billion in investment client funds. We all know of billions of dollars lost by investors from around the world, including sophisticated investors in Switzerland, Germany, London, the United States and elsewhere. Al-

though the details remain sketchy at this point, the scheme has been identified as a Ponzi scheme, meaning early investors were paid phony returns with new monies from later investors. It appears that Madoff maintained a complete set of phony records — otherwise, even a routine SEC audit would have revealed the fraud. One interesting aspect of Madoff's fraud is that he represented to his clients, that he was making large, consistent returns through Covered Call Writing, except he wasn't investing or writing the covered calls at all.

What has not been focused upon is how could so many sophisticated people be defrauded and how could this fraud have been averted? One area that has not been discussed much is the fact that Madoff was both an investment advisor as well as a broker dealer/custodian. The clear lesson to be learned here is to demand that your investment advisor utilize a financially strong, independent, broker dealer/custodian. In the case of Stein Whittington Deniel, we use an independent broker dealer, Charles Schwab & Company as custodian of our clients' assets. Schwab is financially strong and entirely independent of our firm.

**Interview on Website:** Rick Stein's interview with Randy Alvarez about Covered Call Writing and our company continues to show on our firms website. Please call if you would like any information about the website or what we do on behalf of our clients.

**Schwab Alliance:** If you haven't done it yet, please remember to call the Schwab Alliance Team (800) 515-2157, #3 in order to request enrollment in electronic delivery. Please ask to enroll in e-Confirms, electronic delivery of annual reports and 10K's and e-Statements. This will entitle you to receive reduced commissions on equity trades and avoid the clutter in your mail box.

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