Park Piedmont Advisors LLC

Registered Investment Advisor

Helping to Achieve Clients' Goals with Indexed Investments

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JANUARY 2009 COMMENTS

JANUARY 2009 MARKET ACTIVITY (ending Friday, January 30th)

During the month of January, US and INTERNATIONAL STOCK prices had significant declines, while BOND prices stabilized and in some cases showed gains. (Month and YTD Stock and Bond results are on pg. 2). Therefore, accounts dominated by stocks should show declines of 7 to 10% for the month, whereas accounts dominated by bonds and other income-oriented investments should show little change. Accounts with a mix of stocks and bonds/income-oriented investments should show results within these two ranges; the higher the percentage of bonds/income-oriented investments, the better the result.

In trying to get through these very difficult markets, we think it is helpful to refer to David Swensen's observation that investors are not entitled to the highest value their portfolios ever reached, so long as they continue to maintain investments that have the opportunity for risk/declines as well as rewards/gains. (See page 6 of this month's Comments and page 7 of the November 2008 Comments: Swensen is Chief Investment Officer of Yale's endowment, and was just named to President Obama's new Economic Recovery Advisory Board).

As you know, we are major proponents of the view that investing is a long term process, that no one knows when markets will enter periods of significant declines and/or significant gains, and that staying the course is the preferred approach compared to trying to outguess the market's moves. This theme will be discussed further starting on page 6.

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COMMENTS: INDEX RESULTS for period ending JANUARY 2009

	YEAR	YEARS	YEARS	YEAR	YEAR	YEAR	JAN
STOCKS	**1999**	**2000-02**	**2003-05**	**2006**	**2007**	**2008**	**2009**
Vanguard Total Stock Market Index Fund (1)	23.8%	(37.2%)	53.1%	15.5%	5.5%	(37.1)%	(8.3)%
Standard & Poor's (S&P) 500 Index (2)	19.6%	(40.1%)	41.9%	13.6%	3.5%	(38.5)%	(8.6)%
Vanguard S&P 500 Growth Index Fund (1)	28.8%	(48.4%)	41.8%	9.0%	12.6%	(38.4)%	(4.6)%
Vanguard S&P 500 Value Index Fund (1)	12.6%	(26.2)%	63.2%	22.1%	0.1%	(36.1)%	(11.0)%
Dow Jones Industrial Average Index (2)	25.2%	(27.5%)	28.5%	16.3%	6.4%	(33.8)%	(8.8)%
NASDAQ Composite Index (2)	85.6%	(67.2%)	65.2%	9.5%	9.8%	(40.5)%	(6.4)%
Vanguard Midcap US Index Fund (1)	25.0%	(18.3%)	83.9%	13.6%	6.0%	(41.8)%	(7.0)%
Vanguard Smallcap US Index Fund (1)	19.6%	(24.2%)	87.5%	15.6%	1.2%	(36.1)%	(10.2)%
Vanguard International Index Fund (EAFE) (1)	25.3%	(45.9%)	95.9%	26.6%	15.5%	(44.1)%	(12.0)%
Vanguard Emerging Markets Index Fund (1)	61.6%	(29.5%)	162.7%	29.4%	39.0%	(52.9)%	(8.2)%
Vanguard Real Estate Investment Trust Fund (1)	(0.4%)	47.5%	98.6%	35.1%	(16.5)%	(37.2)%	(17.0)%
BONDS							
Vanguard Total Bond Market Index (1)	(0.8%)	30.4%	11.1%	4.2%	6.9%	5.1%	(0.7)%
Vanguard Intermediate Tax- Exempt Index Fund (1)	(2.9%)	23.7%	10.3%	4.4%	3.4%	(0.1)%	3.7%
Vanguard Short-term Bond Index (1)	2.1%	25.8%	6.5%	4.1%	7.2%	5.4%	0.2%
Vanguard Short Tax- Exempt Index Fund (1)	2.6%	13.8%	4.5%	3.2%	4.2%	3.7%	0.9%
Vanguard High-Yield Bond Fund (1); starting 2002	NA	1.7%	30.7%	8.2%	2.0%	(21.3)%	5.7%
Vanguard Inflation-Protected Bond Fund (1); starting 2001	NA	25.5%	20.0%	0.4%	11.6%	(2.9)%	1.0%

NOTE 1: Current Month Results measured from beginning of year, and not beginning of prior month.

NOTE 2: Three-year results start with a base of 100, and after each year's % change, the result for that year creates a new base. So if at the end of the first year the index is up 10%, then the new base is 110%; and if down 10%, then the new base is 90%. NOTE also that a decline of 50% requires a gain of 100% to get back to the starting value, which explains why NASDAQ, down 67%, would require a gain of 200% to get back to its starting value.

1) Results for Vanguard funds include dividends and fund expenses but do not reflect PPA's advisory fee.
2) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's advisory fee.

%	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
		1999				**2000**				**2001**		
S&P 500	4.1	7.6	(7.7)	15.6	2.0	(3.0)	(1.3)	(7.8)	(12.1)	4.8	(13.8)	8.1
NASDAQ	14.6	10.0	0.0	61.0	12.4	(14.8)	(7.2)	(29.6)	(25.5)	12.9	(26.7)	18.3
BONDS	0.0	(0.5)	0.4	(0.7)	2.4	1.5	3.1	4.3	3.2	0.8	4.3	0.0
		2002				**2003**				**2004**		
S&P 500	0.0	(13.8)	(14.1)	4.5	(1.8)	12.8	2.2	13.2	1.3	1.3	(2.4)	8.8
NASDAQ	(5.5)	(19.5)	(13.5)	7.0	2.5	19.2	12.1	16.2	(0.5)	2.7	(7.5)	13.9
BONDS	0.0	2.8	3.6	1.8	0.9	2.7	0.2	0.2	2.7	(2.6)	3.1	1.0
		2005				**2006**				**2007**		
S&P 500	(2.6)	0.9	3.1	1.6	3.7	(1.9)	5.2	6.6	0.2	5.8	1.6	(4.1)
NASDAQ	(8.1)	2.6	4.4	2.5	6.1	(7.6)	3.9	7.1	0.3	7.5	4.0	(2.0)
BONDS	(0.5)	3.0	(0.7)	0.6	(0.7)	(0.2)	3.8	1.3	1.4	(0.6)	2.9	3.2
		2008				**2009**				**2010**		
S&P 500	(9.9)	(2.9)	(7.9)	(17.7)								
NASDAQ	(14.1)	0.6	(8.0)	(19.0)								
BONDS	2.2	(1.1)	(0.5)	4.5								

STOCK index prices for US and International indexes resumed their significant declines during January, after a pause in December. The major indexes declined in a range of -(6.4%) for the NASDAQ Composite to -(12.0%) for Developed International (see pg. 2). See the chart on page 5 for additional details on US stock prices.

BOND returns (price change plus interest) were mostly higher in January, with municipal bonds and (surprisingly) high yield corporate junk bonds posting the best results (see pg. 2). In a major reversal from recent months, the benchmark 10-year US Treasury yield closed at 2.85%, which was 60 bps higher than last month's historically low close of 2.25%. This meant that the flight to quality (i.e., US Treasury bonds, with their extremely low likelihood of default), regardless of yield, had at least temporarily come to an end. Short-term Treasury yields remained at almost zero, as the Federal Reserve kept its short-term rates at that level. In general, as interest rates move lower, prices for existing bonds rise. In the recent environment, however, the credit quality issues impacting various parts of the credit markets have altered this normal relationship of interest rates and prices. For the past two months, there has been movement back to more normal pricing.

ECONOMIC NEWS continued mostly negative, with worsening declines in employment, housing prices, retail sales, consumer spending, and durable goods orders. The initial GDP estimate for Q408 was an annualized negative -(3.8%) (WSJ, 1/31-2/1/09), and the official start of this recession was dated back to December 2007. The key question now is the recession's duration and severity, since it has spread internationally as well. Positive news included continuing low oil prices and low inflation. While there is some discussion of possible deflation, governments' huge infusions of money into various programs designed to reignite economic activity are likely to add to inflation at a future time.

From a longer-term standpoint, the housing and now much more widespread credit problems have triggered a serious world-wide recession, which in turn has produced an historic bear market for stocks. The 2003-07 recovery from the bear market of 2000-02 has ended, and the 2008 price declines have now eliminated all the stock price gains of the past five years. From the 2000 highs to January 2009, the Dow Industrials are now 32% lower, the S&P 500 46% lower, and the NASDAQ a stunning 71% lower. This is likely to be the first decade since the 1930s with cumulative annualized negative stock returns, making these returns obviously far lower than their positive long-term average annualized returns. The mutual fund company Vanguard notes that from 1926 through 2005, in only six of 80 years did stock prices fall within 2%, up or down, of the long-term annual average return of plus 10.4%.

Going back to the bull market that began in 1995, all three major indexes have similar (and, since September 2008, much lower) average annual returns, ranging from 4.3% to 5.4%. (These returns are obviously far below the 10.4% annual average dating back to 1926.)

The moral: Stock returns are truly unpredictable and volatile in short time frames, and can be over long time periods as well, even with (so far) a fairly stable very-long-term average return. Key Questions: Your relevant time frame and tolerance for risk.

	S&P 500 (1)		DOW (1)		NASDAQ (1)	
1st Qtr 2000 High	1,527		11,723		5,048	
Year End 2000	1,320	(13)%	10,785	(8)%	2,470	(51)%
September 21, 2001 Low	965	(37)%	8,235	(30)%	1,425	(72)%
Year End 2001	1,148	(25)%	10,020	(17)%	1,950	(61)%
October 9, 2002 Low	777	(49)%	7,286	(38)%	1,114	(78)%
Year End 2002	880	(42)%	8,342	(29)%	1,336	(73)%
Year End 2005	1,248	(18)%	10,718	(9)%	2,205	(56)%
Year End 2007	1,468	(4)%	13,265	+13%	2,652	(47)%
November 20, 2008 New Low	752	(51)%	7,552	(36)%	1,316	(74)%
December 31, 2008	903	(41)%	8,776	(25)%	1,577	(69)%
January 31, 2009	826	(46)%	8,001	(32)%	1,476	(71)%

Context: Prior Five-Year Gains in Bull Market of 1995 - 1999

	S&P 500 (1)	DOW (1)	NASDAQ (1)
End 1994	459	3,834	752
End 1999	1,470	11,500	4,070
Gain	1,011	7,666	3,318
Avg.Ann.%Gain:'95-'99; 5 years	26.2%	24.6%	40.2%
January 2009	826	8,001	1,476
Gain	367	4,167	724
Avg.Ann.%Gain:'95-12/08; 14.1 yrs	4.3%	5.4%	4.9%

1) Results for S&P 500, Dow Jones, and NASDAQ indexes do not reflect dividends or PPA's fees.

INVESTMENT CONCEPTS

The chart below has been updated monthly to reflect the extreme stock market volatility since the summer of 2007. What appeared extreme in late 2007 and early 2008 has turned out to be a mild prelude to the declines of September-November 2008.

	S&P 500	Change from YE06	Dow Jones Industrials	Change from YE06	NASDAQ	Change from YE06
YE 2006	1,418	-	12,463	-	2,415	-
10/9/07 High	1,565	10.4%	14,165	13.7%	2,859	18.4%
12/31/07 Close	1,468	3.5%	13,265	6.4%	2,652	9.8%
1/22-23/08, and 3/17 Lows*	1,257	-11.3%	11,635	-6.6%	2,155	-10.8%
5/31/08 Close	1,400	-1.3%	12,638	1.4%	2,523	4.5%
10/10,and 10/24 Lows*	840	-40.7 %	7,882	-36.7%	1,494	-38.1%
10/31/08 Close	969	-31.7%	9,325	-25.2%	1,721	-28.7%
11/21/08 Low*	741	-47.7%	7,449	-40.2%	1,295	-46.4%
12/31/08	903	-36.3%	8,776	-29.6%	1,577	-34.7%
1/31/09	826	-41.7%	8,001	-35.8%	1,476	-38.9%

* Note – These are not closing prices, but "intra-day" lows

Some key observations from the chart:

1) From the October 2007 highs to the most recent November 2008 lows, all three major US indexes are down a huge 54% to 65%, exceeding the declines of 1973-74 and 2000-02.

2) October 2007, May 2008, and the last week in October 2008 were all periods of price recoveries of 10% or more. The December 2008 price recovery, measured from the November lows, ranged from 18% to 22%, but the most recent January declines reduced those gains more than 40%. The only good news about January was that the indexes remained above their November lows. These recoveries illustrate the dangers of exiting the stock market after periods of substantial declines, on the assumption the declines will continue. However, we do know now, with the benefit of hindsight, that each rally prior to November 2008 was modest, given the extent of the declines that followed.

3) Even knowing what we do now about the severity of this bear market, there is no way to determine, before the fact, at what point the lows for this market cycle will have been reached until long after the cycle has been completed.

Taking the Long-term View of Investment Results (Continued from Last Month)

The observations that follow are designed to help our clients cope with the ongoing declines in the values of their portfolios, and the continuing bad news affecting the world's economies and financial systems.

To begin, we would like to restate David Swensen's comments reported in November as part of an interview in December's Worth Magazine. "The only way to sensibly deal with markets is to have a thoughtful long-term plan, and thoughtful long-term plans do not involve radical moves, and certainly not selling things that have gone down… People tend to look at whatever is the highest number that they ever got on their brokerage statement and believe it is theirs. Then, when it goes down, they feel like they lost something. In one sense it wasn't really theirs… (unless they cashed out), which is not what you do, because even if you are 60 or 65 or even 70, you've got a pretty substantial life expectancy. Markets fluctuate, but over longer periods of time, they realize the overwhelmingly likely expectation that equities will outperform."

We think Swensen's points are critically important in dealing with current circumstances:

1) Have a long-term plan, and do not sell investments that are down;
2) Your highest values are not necessarily yours, as long as you continue to be an investor;
3) People remain investors to generate returns for their lifetime needs; and
4) Investment values fluctuate, but positive long term returns are a reasonable expectation.

We would add that since investing is an ongoing, long-term process, and since no one knows when prices reach levels from which they are going to decline, it is important to maintain an investment portfolio with an allocation of safe, income-producing investments, and higher risk/higher potential growth investments, that are appropriate to your particular circumstances. In developing appropriate allocations, we think it is important to consider what part of your financial life is, and is not, within your control.

In analyzing financial circumstances, there are three basic elements:

1) Income from work, including work related retirement income;
2) Returns from investments, including income and changes in investment values; and
3) Spending, including income taxes.

We have most control over our spending, including times when significant life style changes are necessary to bring spending in line with one's work income and investment returns. We have some control over income from work; some have a choice of working or not working, whereas others do not have this choice. But when it comes to investment returns, we have no control, other than how we allocate our portfolios between safe, income-producing securities, and higher risk/potentially higher return securities. Since no one knows in advance which investments will do better in any given time period, the allocations are critical to being able to remain a long-term investor.

We develop allocations designed to fit our clients' particular circumstances. Age, accumulated capital, and other sources of income are key variables. For example:

1) Younger clients, still working, are likely to have most of their allocation in higher risk/higher potential return investments, since they typically have no current spending needs from their portfolios, and have many years to recover from periods of significant price declines. If the amounts invested are modest, which tends to be the case with younger people who have many current demands on spending, that is all the more reason to be heavily allocated to the riskier asset classes, since the amount at risk is smaller in absolute terms, and the impact of substantial gains on the overall portfolio would be substantial.

2) Older clients, not working (or working less), will likely have a totally different allocation, with an emphasis on the safer, income-producing investments. Our allocations typically provide at least five years of spending needs from the safe, income-producing part of the portfolio, so that if a client needs to withdraw $100,000 annually from his/her portfolio, we try to have at least $500,000 in safe, income producing investments. Of course, meeting this objective depends on the amount of capital, and a reasonable relationship between the withdrawal amount and that capital. For clients with substantial amounts of capital, it is not unusual for the safe, income-producing allocation to provide ten or more years of likely withdrawals, as there is less need to take risk for future capital appreciation.

3) In almost all cases, we favor some allocation to the riskier, growth-oriented asset classes, primarily because there is a history of favorable long-term investment returns for these asset classes. Other reasons include life expectancies getting longer and longer (Vic's mother will be 102 years old at her next birthday) and, even beyond our own life expectancies, clients' desires to leave money to family and/or charities.

4) The above comments are of course generalizations; each client has an allocation that we believe is specifically appropriate to that client's needs and risk tolerance.

In addition to presenting our views in these Comments, we also like to highlight the views of others with some insight/experience in investing. In one recent WSJ article (1/29/09, pg. D3) headlined "Where the Financial Gurus are Putting Their Own Money," a number of well-known investors were quoted. While their favorite investments ranged from the conservative US Treasury Inflation Protected bonds and municipal bonds, to the highly aggressive emerging markets and commodities, some of their observations seemed worth reporting. Rob Arnott, head of a major investment management firm, stated that "this is a marvelous time to be investing, and there are more interesting opportunities out there now than any of today's investors have ever seen." The article's author stated that "Unlike many small investors, the financial stars are patiently waiting and watching for bargains rather than making a mad dash for havens like cash or Treasury bonds, or drastically revising their asset allocation plans. And wherever possible, they are … putting more cash to work in the market….Great investment minds don't always think alike, but they appear to have one thing in common: patience, a trait many small investor s seem to lack….This is hardly the time to hunker down and take investments off the table, financial pros say."

Another WSJ article (2/2/09, pg. R5) quoted extensively from a Registered Investment Advisor, Judith Shine, with a remarkably similar approach to investing as ours. "The one thing that torpedoes your portfolio long-term is your short-term behavior." When asked by clients why they didn't have more money in cash and bonds, she told them "she was trying to make their money last for the next 30 to 35 years and stocks have historically generated higher returns than those less volatile alternatives over extended periods….While stocks can go down a lot, history shows that on the rebound, they can regain their losses, and then some, over a period of years. Her clients can take some comfort from the fact she keeps a minimum of three to five years spending needs in cash and bonds… so clients do not need to worry about selling stocks for four to five years…..Clients are urged to focus on the future; the problem with using last week's game to call next week's play is that next week's play might be 180 degrees different. To leave the market at this time would be fighting last year's war." While we recognize that history may not repeat, and that some clients with enough capital only need modest exposure to stocks, we agree that maintaining an appropriate exposure to stocks in an effort to gain higher returns over extended time periods, and staying with the program when markets decline, are sound guidelines for managing investment portfolios.

The article discussed above also raised the question of why we/other advisors do not engage in "Market Timing," such as moving money into cash and safe bonds during market declines. Market Timing refers to the effort to be in the stock market when it is going up, and to be out when it is going down. Aside from the obvious point that if any one could do this consistently, they would be very rich (and certainly not need to give investment advice to others to earn a living), all the academic literature we rely on takes the view that this simply cannot be done consistently over time. This is so because market movements are inherently unpredictable, no matter how clear they appear after the fact.

It is highly appealing to think that investors can simply exit the risky asset classes when they are going down, and return when they are going back up. Exiting is in fact the easy part. The difficult part is knowing when to get back in, because if you are out when the market begins to rebound, you miss much of the return from any recovery that occurs. In one recent study, the investment firm Jennison Dryden (JD) stated that "fears of further declines and market volatility make investors skittish, with many pulling money out of the stock market after absorbing much of the decline. But then they risk missing the subsequent rebound after the bear market ends, which historically have been very robust. Over the past nine bear markets (starting in 1957, through 2000-2002)…once the stock market discounts economic recovery, stock market returns have historically been quite substantial in the following year, followed by lesser returns in the following two years. Thus it is important to be in the market, and experience those returns, when the market does rebound." The average of the nine bear markets showed declines of 32% from high to low, with duration of a little more than one year, and then an average recovery of 36% in the first twelve months. (Remember, however, that a decline of 32% reduces $100 to $68, while a subsequent recovery of 36% raises the value to $92, not even back to the starting value of $100). If you would like to see JD's two page study, we will forward it on to you.

The current bear market, which started in October 2007, provides an excellent example of the difficulty of market timing. From the lows of late November, 2008, the S&P 500 had a 25% gain through January 6, 2009. Someone who sold as the market was declining would have had to make a decision whether the rally from the November lows was the time to get back in. If they did, particularly late in that brief rally period, they would have been looking at significant additional declines by the end of January. And if they did stay on the sidelines, guessing right that time, when will they get back in, assuming they want to at least try to participate in the price gains that come with a recovery? Do not misunderstand that we know when the recovery is coming any more than the next person, or that it is a given that a recovery is coming; we only know that we do not know whether or when the recovery is coming, so we advocate maintaining some ongoing position in stocks and other risky assets, so as to be able to participate when and if the recovery does occur.

One last example of the difficulty of market timing was presented in Jason Zweig's "Intelligent Investor" column in the WSJ (1/24-25/09, pg. B1), in which he cited a study of the Dow Jones Industrials from 1900 through the end of 2008. This study found that "the vast majority of the time, the stock market does next to nothing. Then, when no one expects it, the market delivers a giant gain or loss, and promptly lapses back into its usual stupor….If you took away the ten best days of the almost 30,000 days since 1900, the Dow would lose two-thirds of its cumulative gains over the past 109 years; conversely if you took away the ten worst days, you would have tripled the actual return of the Dow." Trying to pick any of those super-charged days certainly appears to us to be an exercise in futility.

Finally, the question of how the recovery is going to occur should be addressed. We now know there are two key aspects to the hoped-for solution: (1) an economic stimulus package to get people back to work and reinvigorate the economy; and (2) a plan to remove bad assets from banks so they can begin to lend money more freely, also with the objective of reinvigorating economic activity. The debate now is whether these measures will be effective, and not create even greater problems down the road (such as huge, unfinanceable budget deficits, and runaway inflation). We refer you to an excellent article in the NY Times Magazine section (2/1/09, pg. 22), written by Times financial correspondent David Leonhardt, in which he states that "the economy will recover, but not any time soon… Once government finally decides to use the enormous resources at their disposal, they have typically been able to shock an economy back to life. They can put to work the people, money and equipment sitting idle, until the private sector is willing to begin to use them again….But while Washington has been preoccupied with stimulus and bailouts, another equally important question has received far less attention… How should the economy be remade, and how fast will it grow?" We will return to this article in more detail next month.

Nick Levinson

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