September 16, 2009

Wall Street bank Lehman Brothers has filed for chapter 11 bankruptcy protection, rival Merrill Lynch has sought refuge by selling itself to Bank of America, and insurance giant AIG needs emergency funding.

-BBC News September 16, 2008

One year ago, Lehman Brothers descended into bankruptcy. The spectacular collapse of this storied firm sent shockwaves through the world economy as the unthinkable entered our collective minds.

Over the past year, we have managed your capital in way that has balanced short-term uncertainties with your long-term objectives. We thank you for your trust and faith during this difficult period.

From the chaos came great opportunity. As we observed in our client letter this past March:

> *In fact, going back to 1870, the U.S. equity market has only been cheaper on four different occasions. History has shown that valuations can easily go from cheap to VERY cheap, and from expensive to VERY expensive. History, however, has also shown that investments made during periods of fear and low valuations have a high probability of providing fair returns over time. If you don't buy and own assets during periods of great fear and low prices, when do you buy — during periods of giddiness and high prices?*

What has created incremental value for our clients over time has been our willingness to sell when others are greedy, and buy when they are fearful. Our purchases in the beginning of 2009 were difficult, but they have proven highly profitable for our client families. As a result, we have made significant progress toward recovery, restored the integrity of your financial objectives, and collectively we took on an immense new appreciation for risk.

<u>DON'T BELIEVE THE HYPE</u>

As predicted, the popular media once again served as a contrary indicator. Bad news abounded during the recent market depths, and the drumbeat of negative press appeared never-ending. We have often found that the average investor wants to get out of the market when the news is bad and get back in when things look better. History has shown that once investors receive the "all clear" signal to get back into the market, the majority of returns have been realized.

To review, let's take a look at some headlines from the lows this past March:

FINANCIAL HEADLINES 3/4/2009:

- *US car sales in February fell 41% to a 9.1 million annual rate, the lowest since December 1981, when most Americans rode to work via horse and buggy.*

- *ADP reported that companies cut an estimated 697,000 workers in February. This report is a precursor to Friday's non-farm payroll report issued by the Labor Department.*

- *The Wall Street Journal reports that 11 top executives from Merrill were paid more than $10 million in cash and stock last year, despite the Firms $27.6 billion loss for 2008. The Journal was even kind enough to name names and post pictures of the top earners.*

- *20% of home mortgages were underwater, according to a report released by First American CoreLogic.*

- *Public pension funds are hiring, Morgan Stanley's commercial property "opportunity" fund which is set to take a 60% write-down on the equity in its $8.8 billion fund.*

- *AIG has another $12 billion it can punt in credit losses to the U.S Government.*

LOOKING AHEAD

It has been an environment of unprecedented complexity and peril. Barron's Michael Santoli recently highlighted this uncertainty. He observed that one year ago, the most bearish market pundits argued that the S&P 500 would drop to 1,000. Six months ago, the most bullish observers believed it would rise to 1,000.

As we write to you, the S&P 500 is hovering around 1,000. We believe the stock market is within the range of fair valuation. This is typically the most difficult period to invest because there is less margin of safety. Historically, we have made the best investment decisions when we have taken advantage of extreme/irrational financial markets and simply waited for things to become normal/rational.

The past year has been a dramatic chapter in our financial lives. Currently, the economy appears to be heading down a path of recovery. Government policymakers have been successful at mitigating the pain caused by a dramatic fall-off in private demand by increasing government spending. For example, in the second quarter of 2009, real U.S. gross domestic product (GDP) decreased at an annual rate of 1 percent. This is propped up by real federal government spending which increased a whopping 11 percent.

Now, the baton must be passed from the public sector to the private. We are looking for three things to occur:

1) The U.S. credit markets must become self sufficient and trillions of dollars of U.S. Government support must be carefully removed from the economy.

2) Businesses must gain confidence to restock lean inventories.

3) Public sector consumption must be replaced by private sector.

Even if the private sector is once again able to generate meaningful growth, we remain a nation with serious long-term structural, political, and demographic challenges. When it comes to the markets, the only constant is change.

It is said that a bond forged by fire is never broken. During these challenging times, we have grown closer with client families as pretenses were stripped away and the rhythms of everyday life were disrupted. We have enjoyed the privilege of serving as your family CFO.

This year, we have added a new insert in our mid-year report to help you keep up with changes in tax rules and regulations. This feature serves a dual purpose. We believe nothing beats insomnia like reviewing the tax code!

A copy of form ADV Part II was delivered to you earlier in the year. As always, they are available upon request.

As always, thank you for your trust and confidence.

With Best Regards,

Howard Alter   Stephen Shueh