March 20, 2009

Dear Friends and Family,

Blame it on our ventral striata.

We've all heard about "Keeping up with the Joneses." Neuroscience research shows that keeping up with others is a human need rooted in a portion of our brain called the ventral striatum that makes us inclined to compare ourselves with others.

Recent economic events demonstrate what happens when our collective ventral striata runs amok. Bankers, real estate professionals, investors, and associates all had their ventral striata firing like crazy as they tried to rack up larger earnings, live in bigger houses, and drive nicer cars in an effort to satisfy the deep-seated need to keep up with the Joneses.

Aided and abetted by cheap capital, many took on ever increasing amounts of debt to purchase assets such as real estate. Debt magnified returns as underlying asset prices increased. When valuations began to correct, however, debt quickly became a dangerous four-letter word. As we write, the economy is caught in the throes of a vicious cycle as deleveraging negatively impacts asset prices which leads to further deleveraging.

To successfully navigate the road ahead, investors need a broad perspective to understand where we are and what range of outcomes are possible going forward. As we look into the future, it is important to remember that a sound financial plan should make the worst case scenario tolerable.

Your Advisor has spent some time researching prior periods of financial hardship and crisis. We believe that there are many parallels between our current economic environment and that of the Great Depression from 1929 to 1939. In particular, there are four important investment lessons we have drawn:

1. **Valuations Matter**: Fundamentals will ultimately determine asset prices.

2. **Don't Judge the Market by its Cover**: Market lows and highs are usually made long before we read about it.

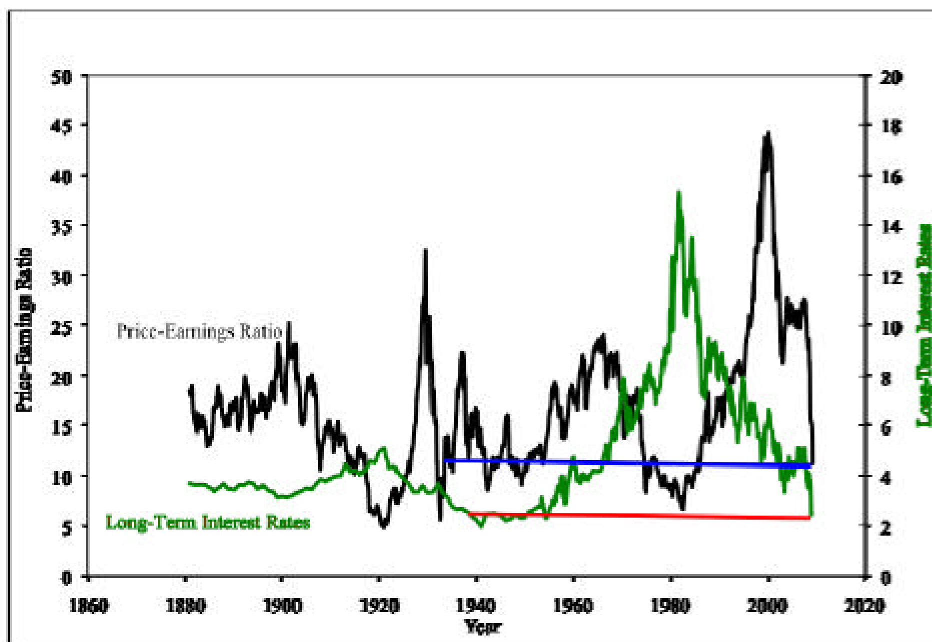
3. **Stress Test Yourself with Your Advisor**: Volatile assets like stocks are only appropriate for investors who do not need near-term access to capital.

4. **It's 90% Perspiration, and 10% Inspiration**: Even during the Great Depression, investors would have made money by following a disciplined dollar cost averaging program.

1. Valuations Matter

In your Advisor's view— on a valuation scale from 0-10 with zero being extremely cheap and ten being the most expensive — we are currently between one and two. 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? Remember how great it felt to buy dot-com stocks in 1999, and real estate in 2005? Valuations do matter.

Currently, the relationship between long-term interest rates and stock market valuation as measured by the S&P 500 10-year rolling price-to-earnings ratio is back to levels last seen during Great Depression.



Source: Professor Robert Shiller

In mid-1932, almost precisely at the bottom of the Great Crash, Benjamin Graham wrote an article for Forbes. Graham — who was later to be known as the father of value investing and Warren Buffett's mentor – was the manager of a fairly obscure fund. Graham's fund had tumbled 70% from its 1929 high compared to a slide of 87% for the Dow Jones Industrial Average.

Graham pointed out that stocks were irrationally cheap. The fact that profits were vanishing almost didn't matter. You could buy companies for less than their net liquidating value.

Graham defined liquidating value in a very conservative way. Take working capital (current assets like cash, inventories and receivables, less current liabilities), then subtract any debt not already included among the current liabilities. By 1932, a third of the industrial companies on the New York Stock Exchange were trading for less than their liquidating value.

July 8, 1932 marked the market low, and the market experienced a powerful rally from 1932 to 1937 that saw the Dow Jones Industrial Average rise over 470% from 41 to 194 in an environment of continued fear and economic depression.

2. Don't Judge the Market by its Cover

When it comes to investing, we think too much. Psychological studies have confirmed that we all have biases when we allocate capital, and that the most dangerous one is 'recent event bias.' Recent event bias is the human tendency to extrapolate recent events into the future indefinitely. Nothing does more to make investors greedy when they should be fearful, and fearful when they should be greedy.

The media serves to propagate recent event bias. They are cheerleaders of trends.

In today's environment, bad news abounds, and the drumbeat of negative press appears never-ending. We often find that the average investor wants to "Get out of the market when the news is bad, and get back in when things look safer." History has shown that once investors receive the "all clear" signal to get back into the market, the majority of returns have been realized.

For example, a growing concern is the rising rate of unemployment. But is bad news for our paychecks bad news for our investments?

Penn Financial Group recently took a look at the last five US recessions dating back to the early 1970s. Three of the five recessions saw the unemployment rates continue to rise even after the recession was officially over. During all five recessions, the stock market bottomed months before the worst unemployment reading was released. When the most dire news was released, the S&P 500 was up on average 30% from the lows.

Unemployment rates during the Great Depression provide a clear example of the inverse relationship between markets and economic news. In 1929, the unemployment rate hit a low of 3.1% as the market hit a multi-year high. At the market low in 1932, the unemployment rate reached 23.5%. It is worth noting that the unemployment rate continued to worsen into 1933 reaching almost 25% even though the market low was made the prior year.

Year	Population	Labor Force	Unemployed	Percentage of Labor Force
1929	88,010,000	49,440,000	1,550,000	3.14
1930	89,550,000	50,080,000	4,340,000	8.67
1931	90,710,000	50,680,000	8,020,000	15.82
1932	91,810,000	51,250,000	12,060,000	23.53
1933	92,950,000	51,840,000	12,830,000	24.75
1934	94,190,000	52,490,000	11,340,000	21.60
1935	95,460,000	53,140,000	10,610,000	19.97
1936	96,700,000	53,740,000	9,030,000	16.80
1937	97,870,000	54,320,000	7,700,000	14.18
1938	99,120,000	54,950,000	10,390,000	18.91
1939	100,360,000	55,600,000	9,480,000	17.05
1940	101,560,000	56,180,000	8,120,000	14.45
1941	102,700,000	57,530,000	5,560,000	9.66

A lot of people rely on the media to tell them when to invest. We thought it might be helpful to provide front-page news from The New York Times at some major market bottoms and tops in the 20th century.

News on the Days of Major Market Bottoms in the Dow Jones Industrial Average

Date	**Dow Jones Industrials**	**The New York Times**
August 24, 1921	64	*Pretty much all markets relapsed yesterday into an attitude of indecision and drift... In all respects, the markets reflected the apathy common to this stage of the business season... The growing conviction that industry need expect no important recovery during the balance of the year leaves the markets without direct inspiration to recovery... It is the relatively very low range of prices, both for investment securities and for commodities, which is the real element of strength in the general position.*
July 8, 1932	41	*It is not to be forgotten that the amount of money loaned on stock collateral to brokers is reduced, not only by inactive speculation but by the extremely low average price to which stock values have fallen.*
June 13, 1949	162	*Nothing has occurred in the last week to rescue the stock markets from their dreary plight. Wall Street has not set a good example, and persistent harping on an American business recession has been much to the liking of bear speculators... There is almost complete lack of confidence in the economic or political situation, either at home or abroad.*
August 12, 1982	777	*Extending one of its sharpest declines in recent years, the stock market yesterday continued to retreat on modest trading volume. Analysts attributed the setback to the same set of worries – a slack economy, disappointed corporate profits, and fear of huge budget deficits – that have prevailed recently... "The market acts like more bad news is coming," stated William M. LeFevere of Purcell, Graham & Company...*

News on the Days of Major Market Tops in the Dow Jones Industrial Average

Date	Dow Jones Industrials	The New York Times
September 3, 1929	381	*Even in this era of unbounded speculation, enthusiasm, predication in all these matters is reserved… Three different attitudes seem to be taken in regard to the financial future. One is that we have now discovered positively the existence of a new financial and industrial era in which old rules are wholly abrogated and past experience has no lessons worth considering. Another is that the recent trend of affairs in the industry and in the speculative markets cannot last; that is reversal, when it comes, may be severe in proportion to the violence of the movement which is interrupted, but that no one can fix the time and circumstances for the change. The third position probably occupied by the greater part of the financial community is that reasoned judgment has been discredited so often in the past three years that it may as well be suspended for the present and that whatever underlying convictions may be entertained, it is just as well to go with the stream, while watching the longer horizon carefully.*
February 9, 1966	995	*The goal of reducing the unemployment rate to 4 per cent… was reached in January, the Labor department reported today. It was the lowest unemployment rate for any month since April 1957, almost nine years ago, when the rate dipped to 4 per cent for just one month.*

3. Stress Test Yourself with Your Advisor

Volatile assets like stocks are only appropriate for investors who do not need near-term access to capital. As you move up the risk ladder from cash to equities, your time horizon must get longer since near-term movements are unpredictable.

As an illustration, there were many head fakes during the Great Depression. The chart above details eight double-digit percentage-point rallies that took place during the market slide from 1929 to 1932.

There are many stories from the Great Depression of people who chased rallies and committed more capital than they were comfortable committing. When the markets fell further, these people could not tolerate the pain of near-term losses and sold at, or near the bottom, only to miss the powerful rally from 1932 to 1937 that lifted the market almost fivefold.

Please take the time to review a wide range of possible outcomes with your Advisor. If the worst-case scenario does not derail you from achieving your long-term financial goals, you will sleep better at night, hold greater conviction toward the investment process, and more easily ride out bear markets.

4. It's 90% Perspiration, and 10% Inspiration

It is very difficult for most people to stick to a long-term investment plan because we are surrounded by so much short-term temptation. We all hear stories of how a friend or family member sold all of his stocks before the recent market slide and is now sitting comfortably in cash. During the real estate boom, we may have known an enlightened neighbor who plowed all of her savings into condos, took on a lot of leverage, and seemed to be on easy street. Remember the dot-com millionaires we envied? The important question is, "How are they doing now?"

Successful investing is 90% perspiration and 10% inspiration. It requires people to act in a disciplined manner, and to ignore the herd mentality. As Warren Buffett noted in his 2008 shareholder letter, "Approval… is not the goal of investing. In fact, approval is often counter-productive because it sedates the brain and makes it less receptive to new facts or a re-examination of conclusions formed earlier. Beware the investment activity that produces applause; the great moves are usually greeted by yawns."

As an example, let's return to the Great Depression period. If you simply dollar-cost averaged during the decade from 1929 to 1939 by investing $1,000 into the Dow Jones Industrial Average at the beginning and middle of every year, you would have realized a gain of 25% by the end of 1939. This gain is even more impressive since the period from 1929 to 1939 was a deflationary decade, and the Dow Jones Industrial Average ended down about 50%. The chart on the next page highlights the outcome:

	Dow Jones Industrial Average	Buy $1000	Shares Purchased
Jan-29	300	$1,000	3.33
Jun-29	331	$1,000	3.02
Jan-30	248	$1,000	4.03
Jun-30	226	$1,000	4.42
Jan-31	164	$1,000	6.10
Jun-31	150	$1,000	6.67
Jan-32	77	$1,000	12.99
Jun-32	42	$1,000	23.81
Jan-33	59	$1,000	16.95
Jun-33	98	$1,000	10.20
Jan-34	99	$1,000	10.10
Jun-34	95	$1,000	10.53
Jan-35	104	$1,000	9.62
Jun-35	118	$1,000	8.47
Jan-36	144	$1,000	6.94
Jun-36	157	$1,000	6.37
Jan-37	179	$1,000	5.59
Jun-37	169	$1,000	5.92
Jan-38	120	$1,000	8.33
Jun-38	133	$1,000	7.52
Jan-39	154	$1,000	6.49
Jun-39	130	$1,000	7.69
Jan-40	150	$1,000	6.67

Total Investment	$23,000
Total Shares Purchased	191.77
Total Investment Value on January 1, 1940	$28,765
Investment Gain (%)	**25%**

Conclusion

Thank you for your confidence. In particular, we appreciate your referrals of friends and family members during this period when it is critical for people to do a strategic assessment of their financial life. We view this as a continued endorsement of our approach to serving as a family CFO.

From an investment standpoint, we have concluded one of the worst investment decades in our economic history. We believe the next ten years will provide investment returns that are highly satisfactory in real and nominal terms.

Given the dynamic environment, it is imperative that you contact us with any important life changes. We welcome your calls, e-mails, and visits. We fear that clients sometimes feel we are too busy or that your issue is perceived as too small. Nonsense. We are here for you at all times and in all market environments.

To that end, we have a wonderful team in place, and have made significant investments over the past year to build a solid foundation for the future.

We have undertaken the following initiatives:

1. We are in the midst of a major rebranding process. Roundview Capital, LLC was created in September 2008, and it provides a platform for the future. Please visit our new website at www.roundviewcapital.com. We will invite all of our client families to join the Roundview family in the coming months as we meet to discuss your ongoing financial plans and objectives.

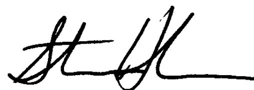
2. As part of the rebranding, we have provided equity options to all employees. It is one thing for the person on the other end of the phone to think like an owner, and quite another to actually have ownership incentives. As they say, no one washes a rental car. Everyone you speak with at Roundview is now an owner and is vested in your long-term success.

3. We want our client families to understand that there is a plan in place for the long-term continuity of the institution that has served many of you for close to two decades. We have built business that is infused with our unique culture and is built to last.

In addition to the 2008 annual letter, this report includes information on your assets, tax information, and other portfolio details. Although you receive much of this information from Charles Schwab, we continue to believe an annual report adds value to our relationship.

We look forward to speaking with you in the coming weeks and months. The United States economy is at a critical juncture in our history, and we will navigate it together. We believe America's best days remain ahead of us, and we continue to persevere and position client families for better days.

Very truly yours,



Howard T. Alter

Stephen K. Shueh

P.S. - Warren Buffett has been widely criticized for an Op-Ed piece he penned for the New York Times on October 17, 2008 where he announced that he had been buying stocks for his personal account. In a world of immediate gratification – where success and failure is measured on an hourly basis – Mr. Buffett swung and missed. The current criticism that Buffett is out-of-step reminds us of the jeers Mr. Buffett faced at the 1999 Berkshire Hathaway annual shareholders meeting where his sanity was called into question for not investing in internet stocks. We believe in the soundness of Buffett's argument for equity investing and the likely long-term benefits of his approach. For those who have not read Buffett's October missive, we have included it below:

"The financial world is a mess, both in the United States and abroad. Its problems, moreover, have been leaking into the general economy, and the leaks are now turning into a gusher. In the near term, unemployment will rise, business activity will falter and headlines will continue to be scary.

So … I've been buying American stocks. This is my personal account I'm talking about, in which I previously owned nothing but United States government bonds. (This description leaves aside my Berkshire Hathaway holdings, which are all committed to philanthropy.) If prices keep looking attractive, my non-Berkshire net worth will soon be 100 percent in United States equities.

Why?

A simple rule dictates my buying: Be fearful when others are greedy, and be greedy when others are fearful. And most certainly, fear is now widespread, gripping even seasoned investors. To be sure, investors are right to be wary of highly leveraged entities or businesses in weak competitive positions. But fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups, as they always have. But most major companies will be setting new profit records 5, 10 and 20 years from now.

Let me be clear on one point: I can't predict the short-term movements of the stock market. I haven't the faintest idea as to whether stocks will be higher or lower a month — or a year — from now. What is likely, however, is that the market will move higher, perhaps substantially so, well before either sentiment or the economy turns up. So if you wait for the robins, spring will be over.

A little history here: During the Depression, the Dow hit its low, 41, on July 8, 1932. Economic conditions, though, kept deteriorating until Franklin D. Roosevelt took office in March 1933. By that time, the market had already advanced 30 percent. Or think back to the early days of World War II, when things were going badly for the United States in Europe and the Pacific. The market hit bottom in April 1942, well before Allied fortunes turned. Again, in the early 1980s, the time to buy stocks was when inflation raged and the economy was in the tank. In short, bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price.

Over the long term, the stock market news will be good. In the 20th century, the United States endured two world wars and other traumatic and expensive military conflicts; the Depression; a dozen or so recessions and financial panics; oil shocks; a flu epidemic; and the resignation of a disgraced president. Yet the Dow rose from 66 to 11,497.

You might think it would have been impossible for an investor to lose money during a century marked by such an extraordinary gain. But some investors did. The hapless ones bought stocks only when they felt comfort in doing so and then proceeded to sell when the headlines made them queasy.

Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: "I skate to where the puck is going to be, not to where it has been."

I don't like to opine on the stock market, and again I emphasize that I have no idea what the market will do in the short term. Nevertheless, I'll follow the lead of a restaurant that opened in an empty bank building and then advertised: "Put your mouth where your money was." Today my money and my mouth both say equities.