

# KAY INVESTMENTS

S E C R E G I S T E R E D I N V E S T M E N T A D V I S O R

April 18, 2009

*It is impossible to introduce into society a greater change and a greater evil than this: the conversion of the law into an instrument of plunder. ~ Frederic Bastiat*

While we speculate on whether the great bear market is over, I observe that we have had an entire bear market and bull market already in 2009! That's right, using the traditional definition of a bull market/bear market as a gain/loss of at least 20%. From January 6 to March 3, the S&P 500 fell 27.6% and from March 9 to March 26, it rose 23.1%.

Volatility is a known characteristic of bear markets, including the final stage. It is also common for a bear market rally to last months and be very profitable before tumbling aggressively to where it began, or to new lows. This type of long, eventually false rally occurred from late 2001 to early 2002.

Bear markets end when the desire to sell is completely exhausted. Usually that precedes a bottoming in the economy by 3 to 6 months. This economic downturn has been particularly steep and perilous because it has involved collapsing values in all 3 sectors: real estate, finance and commodity prices – a rare event. In the financial sector, families and businesses are repaying (and defaulting on) debt, which is highly contractive and deflationary. Additionally, there are many investors who feel the government is fighting recklessness with more recklessness. My information points to the need for caution with the current rally based on market statistics. Although we may leave some profit on the table, my plan is to return to the market in stages, as specific milestones are passed. As of today, we are on the verge of the first 25% reentry.

Ultimately, business and markets hate uncertainty. Because of the uncertainties that remain, there are many observers who make the case that the next bull market cycle could be very tepid. My opinion is that active management will once again be important. Think of 2007, when the S&P 500 gained less than 10% while emerging market foreign funds gained many times that. We are far removed from a bull market like the late 1990's when people picked hot stocks as a hobby. I feel that bonds and market neutral funds will occupy a place even in aggressive model portfolios. One of the funds we're using is the American Century Diversified Bond, which was just named the best corporate debt fund over three years (of 161 funds total) by Lipper Fund Intelligence (email me for documentation regarding this award). Another sector that I have incorporated recently is convertible bond funds – such bonds having an additional feature entitling the holder to convert the bond to the company's stock.

A few clients have asked about the danger of a Bernie Madoff type of disaster occurring with their Fidelity account and/or with my company as advisor. The difference is that Madoff's victims did not

have brokerage accounts in their names. They signed their money over to him, giving up title to it. In your case, your Fidelity brokerage accounts are protected explicitly against fraud. You can read about this by going to [fidelity.com](http://fidelity.com) and clicking on the tab entitled security. Also, if Fidelity went bankrupt, as with any brokerage firm, its shareholders and bondholders would bear the risk – not its account holders. Similarly, if your company went bankrupt, creditors could not make a legal claim on your 401(k) account in order to satisfy company debt.

We moved important amounts of money to cash in 2008, helping the cause greatly. Moving the sidelined cash back into the market is an exercise that guarantees being wrong – either some degree too early or some degree too late. Given that I know I will be wrong, the open question is whether to err on the side of early or late. My feeling is to err on the side of caution, partly because of the tepid bull market that may lie on the other side; partly because I trust in our ability to make money during the next bull market cycle.

Please contact me regarding your risk orientation, your investment model or other matters that you would like to discuss.

### **2009 First Quarter Returns**

While our accounts finished down of course in 2008, we finished down much less than the averages, which lost close to 40%. I began to cash in various stock positions in August and September, before the major drop in October and November. If you would like to review your investment orientation, please contact me by phone or email.

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