

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

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Death of a Notion

The free enterprise system that made this country second to none on earth is in the cross-hairs of an increasingly out-of-touch Washington, D.C. Frank, Dodd, Pelosi, Reich, Schrum, and others boldly, arrogantly, and endlessly flog the whole of in particular Wall Street and free-enterprise in general. As they continue, they risk dousing the spirit of risk-taking which drives our economy. If Mr. Obama places himself in the company of Abraham Lincoln he must better understand that the 16th President was a champion for the protection and nurture of the free enterprise energy of this country. In a famous speech in February of 1859, Mr. Lincoln the patent system “secured to the inventor, for a limited time, the exclusive use of his invention; and thereby added the fuel of interest to the fire of genius, in the discovery and production of new and useful things.” Mr. Lincoln observed that the government was not the inventor, the creator, or the risk taker, but rather the *protector* of the free citizen; protected by this government to take risk in hopes of profit, not vice versa.

Daniel Henninger of the Wall Street Journal observes how in vogue it is to denounce Regan and his policies which unleashed the private sector from excessive restraints and disincentives to growth. Robert Reich recently said of Obama’s budget: “It is the boldest budget we have seen since the Reagan administration, and drives a nail in the coffin of Reaganomics. We can basically say goodbye to the philosophy espoused by Ronald Reagan and Margaret Thatcher.” Robert Shrum said “Obama is not only unwinding Reagan’s policies, he is offering a Rooseveltian paradigm that justifies government pragmatically.” Regan’s response to that remark might be [in his own words] “the government is like a baby’s alimentary canal, with a happy appetite at one end and no responsibility at the other. “

Too bad the Mssrs. Reich and Shrum don’t think more like the first Roosevelt, Theodore, who speaking at the great center of learning, the Sorbonne in Paris said: “It is not the critic who counts; not the man who points out how the strong man stumbles, or where the doer of deeds could have done them better. The credit belongs to the man who is actually in the arena, whose face is marred by dust and sweat and blood; who strives valiantly; who errs, who comes short again and again, because there is no effort without error and shortcoming; but who does actually strive to do the deeds; who knows great enthusiasms, the great devotions; who spends himself in a worthy cause; who at the best knows in the end the triumph of high achievement, and who at the worst, if he fails, at least fails while daring greatly, so that his place shall never be with those cold and timid souls who neither know victory nor defeat.”

Securities markets together represent a real-time report on the sum of the value of the global free-enterprise system. Unfortunately they are expressing exceedingly low confidence in the policies of our new President, Administration, and Congress. After just 44 days, Mr. Obama now presides over his own bear market – a 20% decline in the Dow Jones Industrial Average. It is the fastest drop under a new president in at least 90 years, according to data compiled by Bloomberg. While no one blames Mr. Obama for this mess, markets are sending a clear message that his efforts to address it so far are not even close to the mark.

Without question, investors, we included, had high hopes that the new administration would provide a significant lift to stocks as investors hoped that thoughtful and targeted stimulus measures would be coming soon. These hopes have been summarily executed one after another amidst an almost deafening din of worsening economic news.

One bill after another unapologetically aims itself at growing government at the expense of the private sector, all in the name of coming to the rescue of a mess that Wall Street created. Unfortunately their measures are mostly aimed at rescuing the non-productive elements of the economy while punishing

the productive. Winston Churchill pointed out that a nation trying “to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.” Richmond Fed. President Jeffrey Lacker echoes the sentiment as he criticizes the idea allowing judges to re-write mortgages as a bad idea. He says he prefers that the Fed purchase long-term Treasuries to lower mortgage rates rather than using targeted credit programs which will distort the credit markets and favor one segment over another, creating a moral hazard.

Fed Chair Ben Bernanke is the government’s de facto voice of reason and markets pay attention to him. Last week he sent bank stocks soaring as he set straight the growing fear that large banks were near takeover or nationalization. Obama and his Administration had been saying the same thing through the weekend, but their message was mixed and carried less credibility with investors. In his testimony before the to the Senate Banking Committee he said “I don’t see any reason to destroy the franchise value or to create the huge legal uncertainties of trying to formally nationalize a bank when it just isn’t necessary.”

But on Tuesday he had a chilling effect on markets when he gave a mixed report on banking saying that the stresses in short-term lending have “eased notably,” but that “significant stresses” remain in many markets. He said that the near-term economic indicators “show little sign of improvement,” but added that factors in place (monetary stimuli) “should promote the return of solid gains in economic activity in the context of low and stable inflation.” He warned the Administration and Congress to begin planning for fiscal responsibility. He said that “with such large near-term deficits, it may seem too early to be contemplating the necessary return to fiscal sustainability. To the contrary, maintaining the confidence of the financial markets requires that we begin planning now for the restoration of fiscal balance. As the economy recovers and resources become more fully employed, we will need to withdraw the temporary components of the fiscal stimulus.”

What Are the Implications For Investors?

Market volatility and individual stock or company risks are at all-time highs. Expectations for growth of corporate earnings once recovery begins are lower than at any time in memory as companies face a myriad of new taxes, regulations, and other disincentives. Less-quantifiable, but equally potent is the diminishing appetite for risk-taking, both on the part of managers and of investors. Recovery will eventually come, but most estimates are that it will be anemic at best, suggests that stock returns may be less explosive than in previous post-war recoveries. These concerns all raise in importance a laser-focus on portfolio costs and tax-efficiency. Amplified business, industry, and sector risks make diversification more important than any time since the Great Depression.

We believe that our model portfolios which employ low-cost, tax efficient, and highly diversified index-based investment options have never been more appropriate than they are today. Further, through our Wealthcare® process, we can place each client in risk-appropriate market exposures to meet their cash goals and the timing of those goals. This approach is vastly superior to simply providing a portfolio that delivers a risk level with which the client says he is ‘comfortable.’ He may well be taking more risk than is necessary to meet all of his life’s goals. It is also vastly superior to the popular lifestyle and target-date funds which do not provide the ongoing evaluation necessary as goals and realities change. The average loss in five leading target date 2010 mutual funds was -28.5% last year. Our Risk Averse Model portfolio was down -3%. Why take more risk than is necessary to meet your goals, especially these days?

If you are interested in better understanding what impact recent market declines have had on your future plans, please call us to complete a Wealthcare® review today. Constructive planning trumps destructive abasement. Isn’t there enough of that already?