

CITY SECURITIES WEALTH ADVISORS

Your Life. Your Goals. Your Advisors.

January 26, 2009

I have decided to change the format and frequency of our quarterly letter in response to the volume of important information that needs to be communicated. As the current economic and market downturn gained speed during the fourth quarter, you received several mid-quarter emails and letters from me discussing specific aspects of the economy, your investment portfolios, and personal finance. The response to these shorter and more frequent communications was very positive, so I will continue them as we progress through this period of history together.

This week I want to touch on a broad theme that will provide a piece of the foundation for our dialogue both here and in our meetings and telephone conversations.

We know very well that economic and market downturns are normal, healthy and expected events, but they vary widely in cause, timing, severity and breadth. Astute investors understand this and take actions that capitalize on such events, while employing diversification and other tactics to minimize losses when these events inevitably occur. One thing that makes this market downturn unique is that diversification hasn't worked as expected. Diversification has served investors well by preventing the catastrophic losses that can occur if your portfolio is invested exclusively in assets such as emerging markets, or funds run by Mr. Madoff, as examples. But diversification has failed to curtail equity-like losses for more conservative investors.

So why has asset diversification not worked in this market downturn? In typical markets, fixed income asset classes are incorporated into a portfolio to provide some level of downside protection. In 2008, the only asset class that provided any protection was US Treasuries. All other forms of fixed income experienced significant declines, even high quality fixed income. The reason for this goes back to the origin of this downturn - a credit and liquidity crisis. If an entity needs to raise cash to cover mortgage investments that have failed, and they can't obtain needed credit, then they must sell the higher quality assets they own. This process, repeated by entities around the world, has placed significant downward pricing pressure on otherwise conservative assets.

There are other aspects of this downturn that make it unique, and we will touch on those in future letters. But the fact that traditional diversification hasn't worked very well is an important one, particularly in understanding the losses that are being observed in more conservative portfolios. It is also important because it points to potential opportunities for investors. As credit markets begin to stabilize and liquidity returns to the market at some point in the near future, the opportunity exists for significant gains in these fixed income assets that are currently being priced well below their rational market value.

Our portfolios consist of about 14 different asset classes ranging from US Treasuries to international stocks. We are monitoring each of these asset classes carefully and making appropriate adjustments to the weightings of each as opportunities are created. In the coming weeks, I will share with you additional details of our investment strategy and how we are positioning portfolios to mitigate further declines while still participating in market increases. We'll also discuss important things you should be doing to ensure the long term health of your personal finances.

Please let me know if you have any questions about this or any other aspects of your finances. Also, feel free to forward this letter to others that may benefit from it.

Have a wonderful week!

A handwritten signature in black ink, appearing to read "Kenneth R. Klabunde". The signature is written in a cursive style with a large, sweeping initial 'K'.

Kenneth R. Klabunde, MS, CFP®
Vice President