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Perspectives – Q4 2008

2008 Markets

The fourth quarter of 2008 saw a continuation of the effects of massive deleveraging of the economy and financial system. Consumers and companies are feeling the effects of the negative forces of a collapsed housing market, a global credit crunch and the worst financial crisis since the 1930s. The recession, which started in December 2007, already is the longest in a quarter-century.

2008 turned out to be the third-worst year in market history, with the Dow down 33.8% and the S&P down 38.5%, with 23% of the decline coming in the fourth quarter. The NASDAQ fell 40.5%, surpassing its 39% swoon after the tech bubble burst. Market volatility was staggering, with the VIX Index (a market "fear" indicator) spiking well above 80. By way of comparison, its previous peak was 40 in Sept of 2002, when the market was down 22%. Daily market swings of over 3% became common, and were driven by mutual and hedge fund redemptions and other institutional and retail investors fleeing the market.

The damage was not limited to U.S. stocks, but crude oil (-48.12), commodities (-36%), Hedge Funds (-18.8%), and international equities (-45%). The only asset classes to escape were US Treasuries, which were up 3.60% (Ten Year) and gold (+4.92) as risk weary investors sought safety.

Our portfolios, while not immune to the severity of the market downturn, outperformed the market in 2008 on a relative basis. This was the direct result of a drastic reduction in our market exposure through the summer as conditions in the credit and equity markets deteriorated. What we experienced in 2008 was unprecedented, and we are fortunate to have taken measures to reduce our market exposure during this period.

2009 Strategy

In response to market instability, there was a coordinated effort by governments around the world to inject liquidity into the markets through interest rate cuts, direct equity infusions, and the outright purchase of troubled assets. Other stabilizing actions included raising FDIC limits on deposits and effectively backstopping money market funds. This combined with the coming Obama Administration's massive economic stimulus package should underpin liquidity, confidence and ultimately the housing market, were all these troubles began. It is our conclusion that stabilization of the U.S. housing market will ultimately lead us out of this recession.

We at ACM are overwhelming free market proponents. However, given the disastrous state of the global economy and financial markets, innovative and dramatic governmental action was required. We view this support as overwhelmingly positive, and is part of our current investment thesis. The Fed and Treasury actions as well as the stimulus package are aimed at thawing the credit markets, promoting economic growth, driving mortgage rates down to support the housing markets, and reduce unemployment.

Although it is impossible to determine the depth and breadth of the downturn, the market has created significant opportunities for investors willing to look past the current uncertainty and buy high quality companies at significant discounts. This will also require the discipline to hold them through future market turbulence. At this point, the risk/reward profile of the market is to the upside, and increased market exposure is warranted. As evidenced in the last several weeks, the market has begun to look past a spate of negative economic data and has risen 20% off its Nov 20th low. The market, being a forward looking animal, will turn long before the economic data does and bull markets often start when things seem most dire. The market seems to have found some traction off this bottom, and is beginning to discount economic recovery.

With our new optimism comes a healthy dose of prudence. Given the fragile nature of the global economy and financial markets, we must continue to be aware of any signs of deterioration. We have identified a number of critical market levels that, if violated, would increase our caution and cause us to raise cash levels across our portfolios. While we are optimistic about the future and find incredible value in stocks, we will not fight the market and move to preserve capital if conditions warrant.

As always, we thank you for your ongoing trust in our management of your assets and are here for you should you wish to discuss your account or have further questions.

Buddie C. Ballard, Jr., CFA
Principal

Michael T. Turner, CFA
Principal

Note: Recently there have been a number of scandals involving investment firms. These isolated incidents have raised issues of trust and credibility. Most notably, the activities of Bernard Madoff in New York and the devastating impact his actions have had on the investment arena. We have never had any involvement with these entities. We have deliberately aligned ourselves with the largest custody agents to ensure our clients of their access to and safety of their funds. We do not custody any client assets and clear every trade through third parties.

We want to assure our clients that Alpha Capital Management adheres to the CFA Institutes Code of Ethics and Standards of Professional Conduct. We are a SEC 1940 Act reporting investment advisor and abide by the regulatory framework of that Federal Agency. All performance figures conform to the CFA Institutes Performance and Presentation Standards, and we have taken the additional step to hire a third party auditor to verify these numbers.

As unfortunate as these incidents are, they do serve to highlight the value of our independent, non biased business model. We greatly appreciate the confidence and trust our clients place in us.