

The Bakken Group at Smith Barney



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Quotes: "Temporary defeat is not permanent failure"

Napoleon Hill – "Think and Grow Rich"

"The pessimist sees difficulty in every opportunity. The optimist sees the opportunity in every difficulty".

Winston Churchill

2008 Major Indices Returns

Dow Jones Industrials:	- 31.93%
NASDAQ Composite: (a)	- 40.54%
MSCI EAFE: (a)	- 45.09%
S&P 500: 1-year	- 36.99%
S&P 500: 3-year	- 8.37%
S&P 500: 5-year	- 2.20%
S&P 500: 10-year	- 1.39%

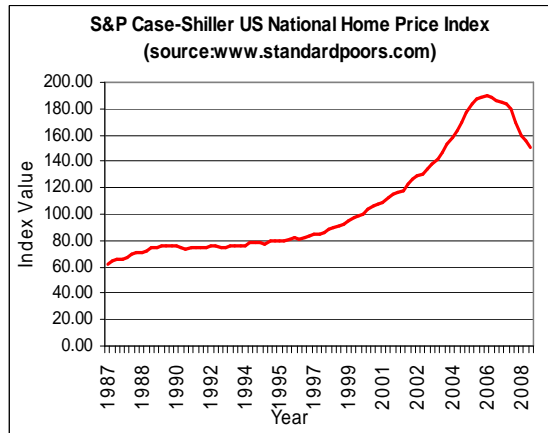
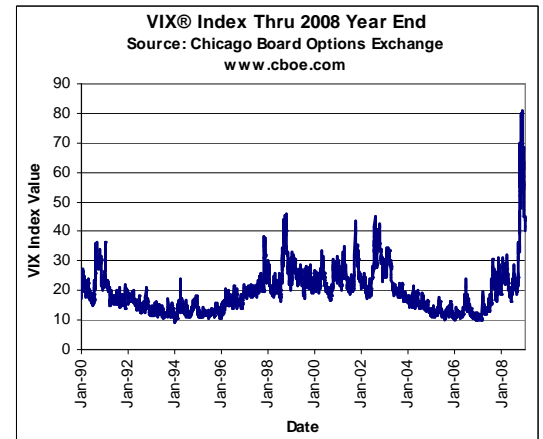
Source: Citigroup Global Markets Inc. (a) excludes dividends

Dow Jones Industrial Average is a price-weighted index of the 30 "blue-chip" stocks and serves as a measure of the US market, covering such diverse industries as financial services, technology, retail, entertainment, and consumer goods. S&P 500 is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. The NASDAQ Composite Index is a market-value-weighted index of all common stocks listed on NASDAQ. The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. As of May 2005 the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. An investment cannot be made directly in a market index.

Markets & The Economy: 2008 is history and it seems clear that we ended the year in a recession of a magnitude that we have probably not experienced in decades. The December 2008 Institute for Supply Management Manufacturing ISM Report On Business® recorded its lowest value of the year at 32.4, well below the growth threshold value of 50.0 (source: www.ism.ws/), indicating continued contraction of our manufacturing sector.

Returns for the major market indices are shown at left. The S&P 500 now has a negative ten-year total return thanks to last year's results. However, overseas markets suffered even more dramatic declines last year and even corporate bonds experienced pressure as many bond prices fell and the yield spread between high-yield corporate bonds and 10-yr Treasuries widened substantially.

"Volatile" aptly describes 2008's equity markets and it was vividly evident in the Chicago Board Options Exchange Volatility Index® (VIX®), a measure of market sentiment and trading volatility.¹ Late last year, the VIX® reached record highs (for all available data) before finally retreating in December. We judge this to be undesirable over the long term but it can potentially create opportunity for the nimble investor. All in all, the price declines of most securities were deep and globally wide-spread.



Mortgage foreclosures and high home inventories continued to pressure home prices and the economy overall last year. Home prices declined throughout 2008 as shown by the S&P/Case-Shiller Home Price Index.² Time will tell how much farther home prices might fall before price stability becomes evident but the graph clearly illustrates the housing price bubble that grew and finally burst over the last decade.

Credit markets remained difficult at year end as the US Government's Troubled Asset Relief Program (TARP) appeared to provide only a limited initial credit market thaw which is no surprise given the size of our economy – it is a big ship that does not turn all that quickly. Credit remained tight and businesses encountered difficulty even in routine areas such as the short term commercial paper market. The Federal Reserve cut interest rates which did help to drive mortgage interest rates down and they also intervened in other areas of the financial & credit markets in an effort to get credit activity started again.

These pressures ultimately conspired to spur significant business and consumer retrenchment. Business spending declined, layoffs became more numerous, and lower consumer spending led to precipitous declines in US auto sales triggering the Big 3's potential bankruptcy. Lower retail spending also ensued and reduced global demand coupled with a stronger dollar led to commodity price declines. One bright spot though was the retreat in both petroleum and natural gas prices bringing welcome relief to consumers.

No IRA RMD's for 2009

In response to the difficult market pressures we all experienced last year, on December 23, 2008 President Bush signed the Worker, Retiree, and Employer Recovery Act of 2008. Among other provisions, this act waives, for calendar year 2009 only, IRA and qualified plan required minimum distributions (RMD) for all clients over age 70-1/2 as well as their beneficiaries.

If you do not need the income from your IRA or qualified plan this year, this may be a way to help your account recover and potentially reduce your 2009 taxes. Please call Sandy or Keith if you have specific questions about this significant and positive change for 2009.

(1) Source: www.cboe.com

(2) The S&P/Case-Shiller Home Price Indices measures the residential housing market, tracking changes in the value of the residential real estate market in 20 metropolitan regions across the United States.

The information set forth was obtained from sources believed to be reliable, but we do not guarantee its accuracy or completeness. Past performance is no guarantee of future results.

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Some History: Today's challenges renew the temptation to seek "safety" in yet more central planning and a further expansion of government perhaps akin to the Great Society and New Deal expansions of the last century. We are loathe to see this happen as free markets have generally served America well for more than two centuries and we remain unconvinced of the value of sustained long-term deficit spending. We are also concerned about a potential lack of leadership today and yet we draw comfort from a fresh read of Napoleon Hill's "*Think and Grow Rich*".

Commissioned by Andrew Carnegie and published in 1938 amidst the Depression's New Deal expansion, Hill interviewed 500 top business people who shared their insights for wealth creation. The book remains a motivational classic and Chapter 7 lists many "fertile fields" in which he believed new leadership would be required, including...

1. **Politics:** He called the need here an "emergency" and noted that the majority of politicians had seemingly become "high-grade legalized racketeers";
2. **Banking:** Hill believed that bankers had almost entirely lost the confidence of the public, noting that bankers sensed the need for reform and were underway with it;
3. **Industry:** The exploitation of working men would need to be a thing of the past;
4. **Education:** New leaders must find ways to teach people how to apply knowledge, not just learn theory, and...
5. **Journalism:** Hill believed that newspapers must cease to be 'organs of propaganda' for the interests which patronize their advertising columns.

The lesson is that we have been here before in one way or another. While every recession and market downturn is somewhat unique, they usually share similar traits such as a pessimistic public, dour news stories, and gloomy predictions of America's ultimate demise & failure.

Back to Basics: There is no telling how 2009 might turn out except to say that we believe that in time "this too shall pass". Some measures of the recession such as unemployment may get worse; fall-out from weak 2008 holiday sales may not be fully evident yet, either. However, it is notable that additional bad news throughout the fourth quarter failed to pull stock markets much lower as they largely traded sideways with somewhat reduced volatility over the last several weeks of the year. Too, as we noted on the front page, volatility can create opportunities. For us, this means being more nimble in seeking potentially oversold companies and with respect to portfolio repositioning.

We think a renewed focus on the basics is in order including an action plan that: 1) reviews investment strategy; 2) reviews asset allocation; 3) seeks new investment opportunities; 4) reassess long term risk tolerance; 5) reviews retirement & education funding goals; 6) looks for ways to invest more; and 7) updates estate plans.

Specific to investment strategy, we judge that now may be an opportune time to consider portfolios focused more upon direct ownership of individual common stocks within diversified portfolios. Our experience and results with this approach within Smith Barney's Portfolio Management Group (PM) platform has led us to conclude that we should expand this further within our practice. Look to hear more about this in the year ahead.

Lastly – keep the faith! Human nature is usually too optimistic in the good times and it almost always remains overly pessimistic during bleak times. Business & economic cycles are just that – cycles. We remain confident about the eventual return of the markets and the economy.

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