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**To Our Valued Clients & Friends:**

So much has been written about the extraordinary year 2008 that I find myself flooded with topics that I would like to discuss with you at the close of the year. So many ideas, yet so little space.

To close out 2008, I would like to address the possibilities of deflation and the deleveraging of America, which may be the most significant change in consumer behavior we have seen in the last 50 years. And, I would like to provide you with a few interesting statistics, provided by Goldman Sachs, that may give insight into how long it will take for us to recover from the investment devastation of 2008. (I hope you don't mind, but at the end of this letter, I will confess to my disappointment with my own generation.)

**Deflation**

I can't recall experiencing a period of deflation during my lifetime so it is a bit difficult to comprehend. While inflation can be defined as too many consumers chasing too few products, thus driving the price of products higher, deflation is the opposite...too few consumers interested in purchasing too many products.

To bring this idea into focus, let's take a look at Las Vegas in early 2005 when home buyers who wanted a home in America's fastest growing city camped overnight outside real estate



developers' offices in hopes of having the opportunity to buy or bid on homes that would be released for sale the next day. Hopeful homebuyers were joined by speculators who participated in the bidding for homes. They watched excessive demand drive prices higher...by double digits annually for several years. It was too many consumers chasing too few products (inflation).

Fast forward to today. Las Vegas, once the fastest growing community in America, has been devastated by the collapse of the construction industry and the downturn in the economy, especially the casino industry. Now, there is no one sitting outside real estate offices; there are only homes being sold in foreclosure as the community suffers a foreclosure rate 30 times the national average. Home prices have fallen more than 60% in the last two years, and banks are engaged with repossessed properties in a "race to the bottom."

Homeowners who are current with their mortgages

are unfortunately trapped by deflation in Las Vegas. Imagine purchasing a home for \$300,000 in 2005 with perhaps a \$240,000 mortgage (you put down 20%). Now, two similar foreclosed properties are for sale on your street and are being marketed by two separate banks. The banks have priced the homes at a market value of \$120,000 (a drop of 60%). Yes, \$120,000. There you sit, current with your \$260,000 mortgage, and now you watch the two banks willing to drop their price even further on their foreclosed properties in a "race to the bottom" until someone will finally buy the property (deflation—too many products, not enough buyers).

Now, the interesting thing about deflation is that it's not that people are "not buying" because they can't afford the purchase...they're not buying because they don't know how low the ultimate price might fall. The longer they wait the further the price falls. Of course, deflation is not only affecting housing. This pricing scenario is also applicable to cars, clothing,



*"The papers are full of stories about families who, because of falling home prices, are now 'upside down,' owning more on their homes, furniture, and cars than the items are worth."*

etc. Everyone is waiting to see whether the seller or the company is so desperate to move its merchandise that the price will fall further.

I believe that deflation normally runs its course when the true balance of consumer interest and product price stabilize and then a new price level is established. Of course, then inflation begins to reoccur and the cost of goods begins to drift northward again. That is unless consumers alter their traditional consumption habits, which I believe, we are about to see.

### **The Deleveraging of America**

Looking back at our country in the 1970s, the average family had an average saving rate of about 9% of their annual income. The 1980s saw the savings rate fall by half to 4 ½ %, and finally to less than 2% during the 1990s. Since the turn of the millennium, the country has had a negative savings rate with consumers spending in excess of their annual income.

You don't have to look far to see the leveraged consumer. As I have mentioned before, a young couple, especially with two incomes, has been able to purchase a large home with a small down payment at historically low interest rates. They could furnish the house, perhaps not having to make a payment on their furniture for up to three years, and they could go out and purchase two large SUVs with nothing down and with zero interest cost. It is possible that a young couple could easily find themselves leveraged 10 to 1 with regard to their debt versus net worth.

The papers are full of stories about families who, because of falling home prices, are

now "upside down," owing more on their homes, furniture, and cars than the items are worth. To add fuel to this deteriorating situation, the economy is slowing so quickly that we may see double-digit unemployment in the first quarter of 2009. So, not only are families upside down, but now, they face the uncertain future of their employers downsizing.

It goes without saying that these folks won't be stimulating the economy anytime soon, and while they represent a small percentage of the American public, the rest of us read about their plight and are not eager to go out and make consumption decisions with so much uncertainty in the air.

Combine this uncertainty with a growing disgust by many of us as to how, as a society, we have overindulged ourselves while exposing our families and our country to forces that don't necessarily have our best interests at heart, and one can see that 2009 may be a year of adjustment for our country.

As 2009 begins, I see so many potential unprecedented forces at work that I don't believe anyone can accurately forecast what effect these forces will have on the investment market:

1. *Unemployment in double digits in 2009.*

2. *Bankruptcies and foreclosures at unprecedented levels.*

3. *A \$1,000,000,000,000 stimulus package, reflective of Roosevelt's New Deal, which will be entirely financed with debt.*

4. *The collapse of one, or possibly all, of the American automobile companies.*

I am sure that I could list at least a dozen items of major concern for 2009, but we'll have to see how this new administration addresses our country's growing number of concerns. It may be wishful thinking, but I have hopes that the country might show a willingness to return to the core values that made it great to begin with. A new commitment to prudent savings and investment and innovations that may lead to energy independence, combined with a \$1,000,000,000,000 infrastructure stimulus plan, may result in the country being almost unrecognizable five years from now.

So, for the year 2009, the bottom line is that while I also believe we'll get off to a very slow start, I believe the investment markets will actually end on the positive side at the end of 2009. I do not see a great deal of downside (below the recent low of 7,700), although we may have to revisit that level before the market begins to rebound. I believe that the market has already discounted most of the bad news in the economy. The market decline of more than 45% this year was more rapid and abrupt than most bear markets. I think unemployment will accelerate in the first half of 2009, which may be a bit frightening, but it has already been calculated into the market. (Barrons recently suggested that when unemployment figures were supplemented by the underemployed number the figure might be reported as high as 16-18%.)

In regard to market evaluation, I believe the "normal" price earnings ratio used during the past two decades will no longer be the "norm" in measuring the security value. In the past,

the market has been willing to support a ratio of \$15 to \$20 being paid for every \$1 of earnings, thus, the price/earnings ratio. (A company making \$1 per share with a price earnings ratio of 20 has traded at \$20).

I believe that the new price earnings ratio will settle in between 10 and 15, or lower, and when brokers try to suggest to you that the market is a bargain at this level, don't listen! Returns will be modest, so you will have to save more or simply retire later, and that's all there is to it.

### Recovery...How long will it take?

You have hopefully observed that as 2008 unfolded badly, I began to build our cash reserves inside our Thoroughbred program to a point that by mid-September we held more than 35% in cash. The remainder of our accounts were mostly balanced funds that were a combination of cash, bonds, and stocks. By mid-October, through further liquidations, our Thoroughbred accounts had grown to as much as 60% cash and bonds. This leads to the question: how will this action affect our ability to recover when the market begins to rebound? Goldman Sachs has given us some excellent data that looks back at the 2000-2002 bear market that may provide us with significant insight to the question of "How long will it take to recover?"

Let's review that period that began March 24, 2000 and lasted until October 9, 2002. This bear market lasted 31 months and saw the S&P 500 drop 47.4%. The current drop of 45% has taken only 12 months.

Now, here is the data that Goldman Sachs has provided; it actually runs a bit

parallel to what we have just done to our Thoroughbred accounts. In the 2000-2002 market, if you raised 30% cash in anticipation of bad market conditions and left the cash as a cash position and did not reinvest those funds when the market began to rebound, how much of a loss would you experience during a bear market? How long would it take for you to recover? And, what would your portfolio look like when the S&P 500 fully recovered from the downturn? Remember we are looking at 2000-2002 bear market data.

First, the S&P portfolio. Let's imagine a \$1,000,000 portfolio entering March 2000. It would ultimately drop 47.4% to \$526,218 in October of 2002. It took 48 months, until October of 2006, before the S&P portfolio returned to the \$1,000,000 value figure.

In contrast, a portfolio that was invested with a 70/30 mix of stocks and bonds (a reflection of many of our accounts) that had a 30% cash position raised before the dramatic decline began would have dropped by 13.6% from March 2000 to October 2002. This would have resulted in the \$1,000,000 portfolio dropping to \$864,089.

Recovery to the \$1,000,000 figure for this portfolio took 14 months, to December 2003 (in contrast with the 48 month recovery time of the S&P 500). By the time that the S&P portfolio regained its full value in October 2006, the cash-oriented portfolio was worth \$1,267,445. Not only did the portfolio not experience the gut-wrenching drop in value that the S&P did, but its value also exceeded the S&P portfolio by 26% by the time the S&P portfolio had fully recovered. Now, while this is interesting data, it doesn't give us an

exact date for our projected recovery, but it might suggest that the action we have taken during the past year may result in our recovery time being approximately ¼ of the recovery time of a full S&P recovery (14 months vs. 48 months recovery in the 2000-2002 era example).

The "warning" I should give you here is that I have no intention of allowing the 30% in cash to sit on the sidelines as the market recovers. A good bit of that cash has already been reinvested in corporate bonds that we have found to be attractively priced. The bond investment will be followed later this year by investments in both higher yield bonds and treasury inflation protected bonds once we feel the economy is in recovery mode. Finally, even later, we will be directing funds to a BRIC investment, which is an international fund, designed to invest in Brazil, Russia, India, and China, where the markets have been absolutely crushed this year (Russia will probably be dropped from this fund because of the uncertainty of that region).

While 2008 has been a very difficult year, I am proud of our clients and our Thoroughbred portfolios. I'm proud of our clients not only because of their demonstrated sophistication but also because of their ability to communicate to us their true risk tolerance for their investments. That has allowed us to structure our Thoroughbred portfolios in a manner that has reduced the damage of 2008 significantly.

### And, Finally...

Contemplating 2008, the one thing I am most disappointed in is my own "Baby Boomer" generation. Our generation was handed so much by the greatest generation, as defined by Tom Brokaw. Our




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*"Perhaps it is not too late for my generation to improve the legacy that will be left behind by its actions. Perhaps (they) might begin... by giving up their afternoon lattes."*

*If you would like to have a copy of your statement from Clark Financial Advisors listing all of your accounts and their current values, please email or call Mario, and he can update your statement and forward it to you.*

parents created an atmosphere and culture of hard work and a desire to insure that each succeeding generation would be left better off than the preceding one. This greatest generation fought a war, a police action in Korea, and developed an economy and standard of living that became the envy of the world. By the end of the Korean conflict and the completion of the interstate highway system, the largest infrastructure project up until that time, the country's national debt was still less than one trillion dollars (it was well under two trillion when Jimmy Carter left the White House).

Today, as Baby Boomers approach retirement, the national debt has risen to over \$11,600,000,000,000... 90% of which has been added to the debt since Jimmy Carter left office. In addition to our national debt, we have left an unfunded Social Security and Medicaid obligation to the next

generation, which will be an overwhelming burden.

There will never again be a generation that was given so much by the previous generation that will leave such a burden for the next! But, perhaps it is not too late for my generation to improve the legacy that will be left by its actions. It will take quite an alteration to the generation's indulging ways and the resolve to think of others instead of only themselves. Possibly quite a task...yet even the longest journey must begin with the first step. Perhaps the baby boomers might begin their journey by giving up their afternoon lattes.

#### **A Bit of Bookkeeping**

Attached you will find the firm's privacy notice that is required to be delivered to you annually by the Securities Exchange Commission. (SEC)

Early in 2009, you will be able to view online our

internal reporting statement, which consolidates all of your investments onto a single statement. Until the time you may view your statement online, you may request a statement that will be delivered to you in less than 24 hours with your current consolidated positions.

If you are not receiving periodic emails from me, which include brief market commentary, please email me immediately to let me know that you need to be added to our "Clients and Friends" list. Unfortunately, several months ago we had a computer malfunction that collapsed our email list, and we have been rebuilding it ever since.

Well, that's it for 2008. Thanks for being such great clients and friends!

Warmest Regards,

*M. Brooks Clark*  
MBC/BC  
Enclosure

## **The Numbers**

	4 <sup>th</sup> Quarter Change	2008 YTD Change	12/31/2008 Index
Dow Jones Industrial	(19.1)	(33.8)*	8,776
S&P 500	(22.4)	(38.4)	903
NASDAQ	(24.2)	(40.5)	1,577
Russell Value	(22.9)	(38.8)	487
Russell Growth	(23.6)	(39.2)	371
Treasury Index	+28.6	+27.9	119
Barrons Balanced Index	(24)	(29.3)	---

Clark Financial Advisors is registered with the Securities and Exchange Commission (SEC) as a registered investment advisor and annually files an ADV with the SEC as required. The ADV II form provides background on the firm and its principals. If you would like to receive a free copy of this form, please contact Mario Humbert via email at [Mario@ClarkFinancialAdvisors.com](mailto:Mario@ClarkFinancialAdvisors.com). You may also return this page of the newsletter with a note signifying your request for a copy of the ADV II filings for Clark Financial Advisors. Securities offered through Purshe Kaplan Sterling Investments, member FINRA/SIPC. Headquartered at 18 Corporate Woods Blvd, Albany, NY, 12211.