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## **Market Commentary**

The US equity market suffered its third worst year in more than a century with the DJIA posting a loss of 33.8%. The S&P 500 fared even worse with a 38.5% decline. To make matters worse, international markets in general gave up even larger percentages of their market value. As we saw in nearly all asset classes, there appeared to be no place to hide. Cash was king.

In reviewing the bond market in 2008, it's difficult to think in terms of a single market. There was the US Treasury market, and then there was everything else. US Treasuries were the sole beneficiary of the financial crises throughout the year. An insatiable demand for the safest of securities drove interest rates to virtually zero in the Treasury bill market. This phenomenon illustrated the markets acute aversion to risk while at the same time, drove interest rates on inferior credits sharply higher.

In trying to assess the prospects for the coming year, we generally begin by making a list of positives and negatives. You may be surprised to know that the positives appear to significantly outnumber the negatives. The negatives are largely centered on the weakening economy and increasing level of unemployment. It is not unreasonable to expect the unemployment rate to exceed the 9% level before topping out.

Against what appears to be a bleak economic backdrop are a number of positives and potential catalysts that may lift valuations in the future. First and foremost is liquidity. While the de-leveraging of balance sheets was a major negative for the markets in 2008, large amounts of liquidity are being pumped into the financial system through various means. In addition to the government's role, the reduction in oil prices should contribute a significant stimulus to the economy benefiting both companies and the consumer. The market has shown to be forward looking and is likely to respond positively well before economic headlines improve. These factors along with the government's determination to drive down interest rates should influence investors to take on more risk. It is particularly interesting to note that our government currently provides investors the opportunity to invest along side them by owning securities that they have taken equity stakes in, such as preferred stocks.

As we witnessed a divergence between government bonds and the rest of the fixed income market last year, one can expect varied behavior among fixed income securities

in 2009. At current rates, we see no relative value in owning treasuries. However, the corporate and municipal bond markets appear quite attractive with spreads trading at historically wide levels. While security selection is important, we expect these spreads to narrow as liquidity continues to find its way into the marketplace.

In summary, the negative percentage moves and corresponding market volatility in 2008 was unlike anything we've seen in recent history. Over the past 10 years, the equity market has generated a negative return. It appears highly improbable that the next 10 years would yield similar results. While current valuations appear to be quite compelling, it's imperative that one has the time frame and risk tolerance to weather such storms while not diverting from focusing on long term goals. While there may have been no place to hide in 2008, asset allocation and diversification are an important part of the investment process and should be reviewed on a regular basis.

We appreciate your continued support and look forward to reporting to you throughout the year.

Frank Sterneck

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