



January 20, 2009

The fourth quarter of 2008 created the worst decline in the US stock market since the Great Depression. Some good news is that our portfolios held up far better than the market in the fourth quarter, and for the year as a whole. Many signs are beginning to emerge that this Bear Market may be over. The price of crude oil has collapsed to roughly \$45 / barrel. Similarly, most other commodity prices have come back down to earth. The financial markets are apparently beginning to function again. American interest/mortgage rates are at historic lows and the European LIBOR inter-bank lending rate has come down to nearly normal levels. Regardless of what you hear on TV, banks are now lending to both corporations and individuals who have good credit. The panic selling in the stock market has apparently ceased, and the volatility index has declined. My educated guess is that we could be very close to, or possibly already in, the next Bull Market.

During the fourth quarter of 2008, the S&P 500 Index with dividends declined 21.94% and the Value Line Composite index declined 35.34%. For the year, the S&P 500 with dividends index lost 37.0% and the Value Line Composite Index lost nearly half its value, or 48.69%. Although I am cognizant of our portfolio losses I am encouraged by out-performing both benchmark indices. On the bright side, I do believe the portfolios are positioned to achieve real gains upon our expectation of the market returning to its former levels.

During the fourth quarter, we continued to selectively sell covered calls, and thereby raise a bit of cash. I also made our first commitment to purchase additional shares of stock. We purchased additional shares of Manitowoc (MTW) to reduce our average per share price of that holding. Our nominal cash position declined a little to roughly 13 percent.

TIMING MODEL

The Timing Model strengthened in the fourth quarter. It moved to a neutral reading of 50%. Thus, it predicts a 50% chance of market appreciation and a 50% chance of market decline over the next 3 – 6 months.

2009 OUTLOOK

The US economy had near zero GDP growth during 2008. In retrospect, a consensus of economists has determined that the present recession started back in December of 2007. As we now know, the stock market reacted to the above environment by essentially cutting its value in half. While the recession continues, most of the factors needed to resume economic growth seem to already be in place.

Over the past year, the Federal Reserve (FED) has reduced short term interest rates from 5.25 to essentially zero percent. In addition, large amounts of money have been lent to financial institutions in order to maintain their liquidity/viability. Thus, the financial systems around the world seem to have been saved. Secondly, as I mentioned earlier, the price of energy (both crude oil and natural gas) has come down to levels which should stimulate the economy. Most other commodity prices have also come down to levels which should stimulate future economic growth.

The last remaining drag on the economy is the housing correction. Average housing prices have now retrenched by roughly 25 percent over the last 2+ years. Thus, a significant number of homes have a market value which is less than the size of the underlying mortgage. This has led to a growing number of mortgage defaults; which in turn places downward pressure on housing prices. Fortunately, the Fed has done some magic. Long-term mortgages are now available (to credit worthy individuals) at a rate of roughly 5%. Thus, the defaulted mortgages are either being reworked by the banks, or the homes are being purchased by more credit worthy individuals. As these defaults dry up, housing prices should stabilize; and then be expected to resume their upward climb.

As you probably know, the stock market is perceived to be a leading indicator, and history shows us that it usually begins to recover roughly 6-9 months before the economy begins to recover. President elect Obama will take office in less than two weeks and he has communicated a commitment to a very large tax cut and stimulus program. As I mentioned earlier, stock market prices have been cut in half. I firmly believe that at the present time the potential reward of investing in equities far outweighs the potential risk.

I wish you all a healthy and prosperous New Year, and thank you for your continued confidence.

Sincerely yours,

Ray Hofshi

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