

## Fourth Quarter 2008 Client Letter

The worst year for the broad market since 1931.....on my watch!! The bottom of November 20<sup>th</sup> should be the low for the cycle. I'm bullish for several reasons:

### **First: Valuations are extremely attractive.**

With 10-year Treasury yields in the 2% range, stocks offer better value. Please see enclosed charts showing this relationship since 1962. Despite the recession many high quality companies are trading at low earnings multiples, less than their growth rates of sales and earnings, creating opportunities to purchase at low prices.

### **Second: Pessimism is rampant.**

The public is bearish...and many professionals are as well. Money managers who missed the bottom are reluctant to commit funds at present levels, hoping for a retest of the November lows. Contrary investing should provide opportunity and risk aversion.

### **Third: Governments around the globe are coordinating stimulus.**

The Fed and Treasury have taken extraordinary measures to create liquidity and have vowed to offer unlimited credit. The new administration's fiscal stimulus spending will take the place of private sector spending in the short run.

### **Fourth: Cash on the sidelines.**

There is almost 50% of the entire value of the stock market in cash reserves...between six and seven trillion dollars. We expect these funds, earmarked for equities, to be utilized as the market climbs as the economic outlook improves.

The S&P 500 was down 22% in the Fourth Quarter and 37.6% for the full year. The following table of sectors highlights the broad nature of the decline.

Sector	Percentage Declines	
	4 <sup>th</sup> Quarter <u>2008</u>	Full Year <u>2008</u>
Basic Materials	30.2	46.6
Consumer Discretionary	22.8	33.3
Energy	14.7	16.5
Financial	39.0	55.9
Healthcare	12.7	23.9
Industrials	22.7	40.5
Technology	24.3	42.5
Telecom	3.0	32.7
Utilities	12.3	30.6
S&P	22.0	37.6

We cannot predict what the market will do; however, we can structure portfolio strategy and tactics to take advantage of themes and to capture the best returns as the market rebounds. The appropriate theme is a return to fundamentals. The Fourth Quarter was clearly a liquidation of stocks held by hedge and mutual funds plagued by redemptions. Stocks with strong fundamentals were sold indiscriminately. The approach I use to choose stocks is based on the fundamentals of sales and cash flow growth at reasonable prices. I am finding many opportunities right now and have begun restructuring the portfolio to capture exceptional returns over the next couple of years.

In 2007, we outperformed the market by a wide margin, while in 2008, we declined at about the same amount as the overall market, and our long-term performance is well above the benchmarks. I expect that the economic recovery will be as spectacular as the decline. The market is starting to discount this recovery sometime in the second half of 2009. We are positioning portfolios in early cyclical stocks such as consumer durables, capital goods, and other sectors benefitting from the economic stimulus plan.

It is now very important to stay the course and not be discouraged with equities. We all have felt the pain of declining values. Let's enjoy the recovery to its fullest.

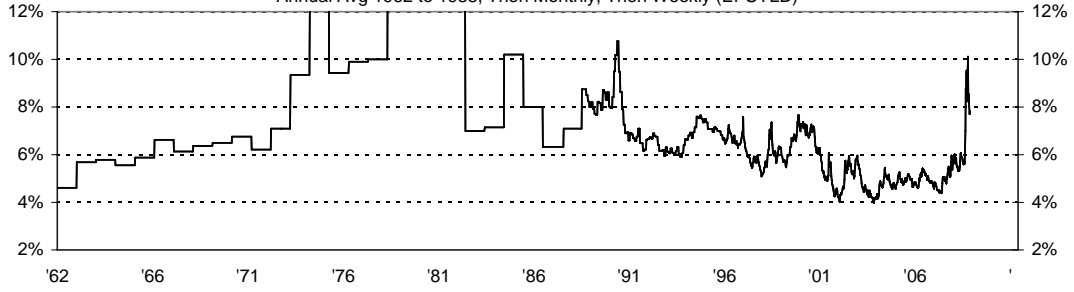
Please call the office at 603-227-5256 or email me at [bhutchens@hutchco.net](mailto:bhutchens@hutchco.net) to discuss your individual needs.

Sincerely,

William D. Hutchens, Jr.

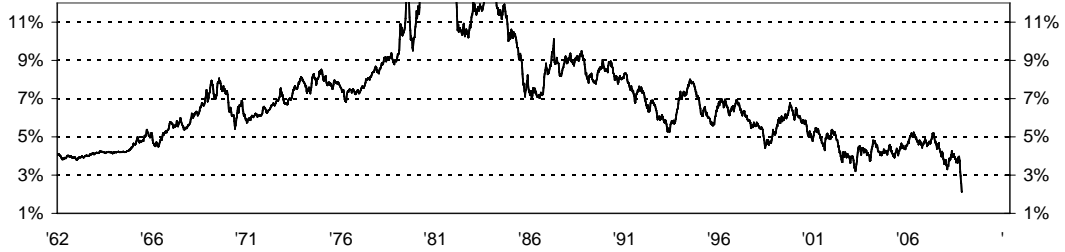
### AVERAGE EARNINGS YIELD ON STOCKS

Annual Avg 1962 to 1988, Then Monthly, Then Weekly (EPSYLD)



### YIELD ON 10 YEAR GOVERNMENT SECURITIES

From 1962 (FRB WGS10YR from USFD & ^TNX)



### NORMALIZED STOCK EPS YIELD VS 10YR GOVT YIELD

Normalized from 1962 (RADJFFEY-GS10)

