GOOD HARVEST NEWS
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Challenging Times, Better Futures?

"This is the Mother of all financial crisis." ~ Paul Volker, January 2009

"It isn't so much that hard times are coming;
the change observed is mostly soft times going." ~ Groucho Marx

Dear Investor –

Happy New Year, and good riddance to last. We have been part of history this past year in so many ways, truly a year for the ages. An historic economic crisis. An historic presidential election, an admixture of despair and hope. A year in which the Mets crashed and burned once again, while the Giants won the Superbowl. A year in which investors' trust and sense of safety was fractured, if not shattered. A year in which former Federal Reserve Chairman and current Obama advisor, Paul Volker, even invoked the immortal words of the late Saddam Hussein in his opening words in front of a Congressional committee.

Yet we survived it, the adaptable creatures we are, and what doesn't kill us makes us stronger we've been told. And despite the prevailing sentiment of gloom purveyed by the talking heads and newspaper headlines regarding the economy, with the risk of being labeled Pollyannaish, we see important positives under way.

Let me be clear, 2009 has the potential to be quite painful in terms of its economic impacts on Americans. We will all know friends or family members who have lost, or are in risk of losing jobs. Institutions, including government agencies and large corporations will be cutting back and eliminating positions thought secure. People who are working, will be working harder. Earners in many areas may see reductions in income, and business owners will suffer longer collection periods and fewer customers. 2009 will be economically tough for many, and lives will be impacted. Stores will be shuttered. That's what a deep recession does. What began on Wall Street has come home to Main Street and your street.

Yet with all this, something positive, powerful, and enduring is emerging. An economy will be regenerating with a greater foundation in science and sustainability. A new political environment, one less contentious, may pave the way for a more constructive political process and a government more focused on service and protection. A new personal ideology will emerge that is less materialistic, less based on personal debt, and more based on sound principles of personal responsibility and self awareness. If you doubt, just look to the new spirit of the youth today, something not seen in decades.

When 2009 comes to an end, we will have seen changes in one year that we could only have dreamt about two years ago. Massive investment in alternative energy. Massive investment in research and jobs and improving infrastructure. Significant tax reductions for the middle class and small businesses. Major advancements toward universal healthcare coverage. Tremendous changes in environmental reform to minimize auto and industrial pollution, including a cap-and-trade system. Enormous changes in investment and banking industry regulation. Unprecedented spending to reduce foreclosures and buttress housing and home ownership. Enormous improvements in education reform and childcare spending. The list goes on….

So, too, the business and the financial system will emerge stronger, more responsive and responsible. And profitable. Do not doubt the astounding levels of creativity and energy that underlie the American and global workforce. The markets will turn around, and a new sanity, a real sanity stands to take its place.

It may take a while, but it will happen. So keep the faith. Stick to your plan. Adjust your goals if you need to, but stay focused on the real things that matter: money never bought happiness. Patience and sanity will win out, and a better economy stands to emerge in the time to come.

In Peace,
Ron Stein

Summary:

- The economic downturn anticipated in 2007 is more severe than originally expected due to a series of issues, including a bursting of the housing bubble, slow government response to a massive credit crisis, sub-prime and other credit-related financial woes, extreme volatility in oil and other commodity prices, a collapse in consumer confidence, and a broad global slowdown.
- Economic strengths, including a resilient global economy, improving liquidity, modest inventories, and strong corporate balance sheets will help blunt some of the economic challenges.
- Massive government response has and will provide a tremendous buffer and enormous economic stimulus to help the economy rebound.
- Market drops are creating attractive valuations and revealing new buying opportunities.
- We have been taking a cautious approach regarding client portfolios, and will continue to do so until we see clearer indications of economic recovery.

2008 -- Goodbye and Good Riddance

Stories. How many of us, particularly us baby boomers have heard them: “The Great Depression was so bad we didn’t know where the next meal was coming from.” “People lined up for rations of food.” “Seemed like everyone on the whole block was out of work.” Each generation has probably had some sordid episode to relate around economically horrible times -- until the post-World War II generation. The Baby Boomers, and Generation X and Y’ers have more or less gotten off scot free. Sure, we had our travails and traumas – 9-11 and its recession aftermath come to mind -- but most born after WWII have experienced an age of innocence. They have sustained a certain inherent belief and trust that somehow things would be ok, that our financial system, as much as we may distrust their motives and operations, will be there, that there is sufficient collective intelligence and responsibility in those managing the world’s financial resources to move us through the normal ups and downs of life.

But 2008 brought us something altogether different. A year in which the inconceivable met the impossible. A year that forces all of us to humbly toss our respective ideologies and paradigms aside, and consider different consequences and results. A year in which the sinews of industry and finance threatened to unravel and leave for many to see the tenuous and worn fibers that had been so precariously underpinning what we thought was solid and safe. A year for Chicken Littles and skeptics and cynics to celebrate, and for even the pragmatists to consider these circumstances not merely a dangerous aberration but a portent of permanently and radically shifting economic ground.

We talked much last year about the perfect storm of events that led the economic equivalent of the 100 year flood: a credit bubble, a housing bubble, excessive consumer spending, poor regulation of financial markets, inability to control key commodity prices, a naturally slowing phase of a business cycle, excessive government debt, over-exuberance on the part of the Federal Reserve to control inflation, overly creative and largely unregulated financial engineering, the globalization of markets, and on and on.

And talk about a paradox: that against this extraordinary painful economic backdrop there is so much hope. 2008’s massive split screen: economic havoc slowly playing out from a small, Wall Street malignancy to a massive economic crisis on one side, versus the growing optimism and excitement and sense of hope and a new paradigm from the candidacy and now presidency of Barack Obama. The paradox is almost staggering.

So let’s talk about 2008. *First, let’s make one thing clear: 2008 has been an extraordinary anomaly.* Willie Mays went 0 for 22 in his first World Series – a rare letdown for one of the most dominant clutch baseball players ever. Just recently, a United Airlines pilot, shortly after takeoff, with two engines out after running into a flock of geese navigated a near-pillow-soft landing feet from waiting piers in the Hudson River. Remarkable and unusual things happen – but their happenings should not be construed to be the norm or future, although they need to be learned from. Just as Willie’s inauspicious start should not have been construed to be representative of his career, our current economic plight should not be interpreted as something permanent.

Unfortunately, during severe economic stressors, the Chicken Little in all of us is hardwired by way of our reptilian and earlier mammalian ancestry to shout out, which often has the added effect of only making matters worse. Accordingly, every severe downturn, even the most recent one in 2001-2003 brought with it similar cries of the imminent end of our economic system and way of life. And as we all know, when we access the more rational part of our gray matter or bother to review the reality of history, it never turns out that way. We've logged about 16 recessions in the US over the last 90 years, and we got out of every one of them, without exception. And while this recession is a downer, it's certainly not the worst (at least thus far) that we've been through since the Second World War, and pales compared to the pre-World War II turbulence.

So we will get past this. As we'll get to shortly, there are numerous positive forces now at play. While certain painful aspects of the economy will continue to deteriorate – i.e. unemployment and household earnings – these are lagging components, and may be slow to reflect the positive change to come. The very elastic nature of economic systems, dramatically enhanced by the rapid and massive response both by our government and those abroad promises a positive outcome, and a very different scenario than played out during the Great Depression. Sorry Chicken Little – the US economy is not going away anytime soon.

The Markets Post Mortem

That said, while 2008 may not have been one of the worst recessions ever, it was still one of the worst years for the investment markets in the last 100 years. This alone is remarkable. Aside from Treasury bonds, bills and notes, there was not a single asset class that really survived, let alone did well. From top hedge fund managers, to the best money managers and mutual funds, performance was dismal. The S&P 500 – the bellweather index of large US companies -- dropped over 37%, International Equities dropped over 43%, and even high quality Corporate Bonds dropped over 2%. Even the vaunted Reserve Money Market fund lost momentary value. The inconceivable happened as asset classes that usually move counter to one another, moved in tandem: downward. The best and brightest investment minds were clobbered.

Rates of Return for 2008

S&P 500 Large Cap	-37.3%
Emerging Markets	-54.5%
REIT index	-39.2%
Developed International Stocks	-43.4%
Commodities	-35.6%
Investment Grade Corporate Bonds	-6.0%
High Yield Bond funds	-25.8%
Long term Municipal bonds	-9.6%
Long Term Treasury Bonds	+27.1%
Cash (3 mo T-bill)	+2.1%

Investors worldwide sold off broadly from even conservative positions to obtain the equivalent of mattress-money rates of returns from their Treasury bills and money markets. Indeed the current T-bill based money market today is yielding under ½%. 10 Year Treasuries are currently under 3% -- all under historical average rates of inflation. In the equity and bond markets, the potency of this credit crunch and recession left nothing whole: from large cap stocks, to high quality corporate bonds, and municipals, US equities, or global. Historically non-correlated investment assets suddenly were correlated. Asset allocation fell by the wayside. Many savvy 401k investors who had diversified their portfolios for years saw their retirement holdings plummet 50% to 60% and more, particularly if measured against their November 2007 peaks. Over $20 to $25 trillion in global wealth was wiped away in those losses during this period. Horrifying indeed.

History Revisited – A Brief, Unpleasant Timeline

The Great Credit Crunch. The Great Distrust. The Poisoned Punch Bowl. What began with a normal and healthy end to a business cycle came down with a crash. Perhaps it began with a housing bubble – as homes were way overpriced, credit way overextended – that grew from the aggressive lending policies and cheap money at the end of the last recession in ’02 leading to absurd levels of personal and commercial debt. Add to this financial leveraging and insuring of products – via credit default swaps and other sophisticated derivatives based on questionable loans and non-regulation – and relaxed capital requirements for investment banks. Add to this sharply increasing commodity and oil prices to atmospheric levels. Add to this a dramatic interconnectedness with major banks and markets around the world. Add to this the huge growth of unregulated hedge funds (over 10,000!) and the enormous pressures they placed on trading and equity markets. Add to this the increasing lack of effective regulatory oversight due to budget shortfalls and incompetence and limited transparency regarding bank assets. The list goes on, and sets the table for the unraveling that began in 2007.

Then it began. Beginning in 2007 came the growing awareness of toxic assets based on improperly priced sub-prime loans held by various investment banks. Fear began driving the markets from August 2007 on, as the lack of transparency of bank holdings became a dominant concern. Fear and innuendo spread about the holdings of this bank and that. Then the inevitable came in March of 2008: the collapse of Bear Stearns, one of the world's largest investment entities, and its forced purchase by JP Morgan due to large toxic assets and positions in credit derivatives. But that was just the beginning as the cascade began with the backdrop of skyrocketing gas and oil prices. IndyMac bank came next, with its poorly performing pool of loans. Then the huge Fannie Mae and Freddie Mac bailouts into the summer, and then in September the ultimate set of blows in rapid succession: the demise of Lehman Brothers, the forced sale of Merrill Lynch, Washington Mutual, and Wachovia, and culminating with the bailout of giant insurer AIG – a catastrophe which threatened the collapse of the entire banking system. The rest is history.

The panic that occurred throughout 2008 was largely based on banks unwillingness to trust lending to anyone, including their most credit-worthy customers. (See our newsletters going back to November and June of '08). The entire global financial system, based on lending, came to a seizing, grinding halt. Banking Armageddon, however, was narrowly averted, and only as a result of a desperate effort by central banks and governments to shore key institutions up in September through November of '08. We were "this close" to the brink – of bank and security runs, riots in the streets, pandemonium. The AIG bailout was the watershed event, and without the emergency TARP plan, however problematic, the entire banking system could have come crashing down. Then, just as we thought we were through everything we could go through, the exclamation point: the unraveling of a $40 billion dollar Ponzi scheme -- by many times the largest in history -- due almost entirely to an unprecedented level of regulatory incompetence.

Now What?

As bad as it was and is, we staved off disaster. And despite the Treasury's TARP missteps – and they are legion – total economic paralysis was stymied. However, we are now dealing with the long, painful convalescence. Though not as long as some in the more distant past, this recession is shaping up to be one of the longest since World War II. With huge sources of capital no longer available to quality businesses and banks, with drastic reductions in demand due to reduced wages and high levels of unemployment, with fellow nations in the world also suffering economically and no longer purchasing our goods for export, with continued distrust between banks regarding fears of what quality of assets remain on their books, what might otherwise have been a normal business cycle end or mild recession has turned into something deeply systemic. The recession's official and distant starting date of December 2007 (by the NBER) seems almost irrelevant at this point. The projected end of this dark reality is late this year, or sometime next. For now, we'll continue to batten down the hatches.

The key indicators remain, frankly, dismal. Over 500,000 new jobless claims are being added each month. Retail sales are experiencing one of the most severe drops in over 50 years. GDP has dropped hard in this last quarter, and corporate earnings have been generally weak and deteriorating. The overall psychology is one largely of gloom. This is what a deep recession looks and feels like.

However, let me point out again that we've been through this before, and will again. [See table in appendix] So while it's easy to harp on the negative, and perhaps that seems like we're doing just that here, the upshot is that we'll be pulling out of this. Moreover, there is good reason emerging behind this.

The Reason We Invest

Historic market drops, painful economic times, uncertain immediate future. So why should any investor not want to rollup right now to the safest bank and unload all their pennies there? Two reasons: few can afford to, and it's a bad idea. While money markets and bank CDs seem like economic comfort food right now, over the long term as investments they don't make the grade except for those who need no appreciation of their investment. In fact, they can't even keep pace with inflation, which means investors lose money by sticking with them. Even riskier corporate bonds can seldom help investors meet their financial goals, as people are living far longer and today's boomers must realistically expect less of government assistance or social security. People will outlive their assets. That is why people today in most cases must – yes, *must* – have a percentage of their assets invested in a portion of higher-yielding or growing assets, unless investors are comfortable with a dramatically lower quality of financial life. If you're happy going off the grid and joining a back-to-the-earth intentional community, that might be viable. But for most people, it isn't.

Since 1925, the S&P500 equity index has averaged a rate of return of 9.5%, bonds slightly over 5%, while cash assets have averaged barely over 3%. With increasing costs of healthcare and goods, most folks even in retirement on a fixed income are finding that over time it's important to keep some assets invested in equities and bond-type investments. A good asset allocation, time and time again, has been shown over the *long* run to be the best approach. Even in 2008, a diversified portfolio would have done less poorly than one invested in pure equities. For boomers nearing retirement, it's almost essential.

There's a reason why the returns are high for some asset classes, and low for others, and that's the reward for the risk. Over the short term, as investors, we know that risk can seem high, perhaps untenable. Over the longer term, however, the rewards usually become evident. The volatility we've been experiencing is part of the "cost" of helping to increase the probability of having a more economically comfortable retirement. We suffer these times so that we can enjoy the longer-term fruits of our investments. Sort of the economic version of "no pain, no gain."

Ideally, then, investors who are capable of taking the very long term view should retain their well-reasoned asset allocations, perhaps chuck their unopened statements in the drawer for a few years, and leave them there. That's all well and good, but few investors have the requisite emotional fortitude, particularly, we've noticed, now. Accordingly, most of our clients have reduced equity exposure at this time. Yes, they've experienced much smaller losses than the broader markets, but over the much longer term, they may not be ahead. But we and our clients are not robots – and factoring in present peace of mind is not something we do not take lightly – and this is a good time for investors to check in with their own feelings of discomfort, while working on balancing those feelings with their long-term goals.

Economic & Market Conditions: Current & Looking Forward

Let's look at the current situation, and begin with where much of the problem began: *Housing*, which was one of the earlier bubbles to burst. New housing starts are down over 45% this year alone, and little new construction is being built. Housing values dropped nearly 7% nationwide in '08, and another 6% drop is projected for '09.

However, on the bright side, housing inventories are beginning to finally decline, and the drop in mortgage rates should soon begin to have a positive impact in the near term as net housing costs – costs of purchase and financing -- are dramatically dropping. Perhaps just an aberration, but just-released new home sales figures for December '08 show an unexpected increase, and mortgage applications are increasing in some areas already. Over the longer term, the underlying demographics – particularly a growing population – means that there will be a continuing need to increase the number of homes. The growing population of young people need starter homes, while baby boomers need to downsize. Despite the recent over-exuberance perhaps of fostering homeownership among the impoverished and lower incomes, particularly via predatory lending practices, home equity is an essential component to healing the ills of the poor and lower middle class.

Unemployment continues to suffer. This was the leg that was expected in early 2008 to eventually drop even while companies desperately tried to hold on to their employees, and it has. The September shock sealed the fate. The December unemployment rate of over 7% continues a trend that will result in a much higher rate by the end of '09, perhaps nearing 10%, according to several forecasts. These numbers don't reflect the fact that many full-time workers are now working part-time, or the hordes who have left the workforce in despair. According to Moody's economist Mark Zandi, that number could approach effectively 15%. We don't see this trend changing until after the stimulus package kicks in, and we could easily lose a net of another million jobs or more by the end of 2009.

On the flip side, the economic stimulus package is targeted, depending upon which Barack Obama quote you wish to refer to, to creating or saving between 2 to 4 million jobs, which should substantially offset job losses, in addition to the extension of unemployment benefits. This is an essential difference from other job loss periods over the last fifty years, which lacked anything near this level of job creation effort. Moreover, job losses tend to lag during recessions, so even while we're seeing the economy turn around, higher-than-normal joblessness is likely to continue before it, too, begins to improve.

Consumer sentiment and spending – the latter comprises over 70% of the economy – dismal in 2008, may be heading for one of the worst years in many. Retail Sales ended the year with nearly a 2.7% drop in December, after 5 straight months of sales declines. With credit hard to obtain, with people fearing job cuts and reduced payroll, with higher unemployment, with major personal investment losses, and with the entire psychological mindset turning strongly negative, 2009 bodes poorly. Consumer Confidence, which had started to improve slightly, has once again headed downward. Car sales will remain weak, and homeowners can no longer tap into equity lines of credit like bank accounts to purchase those large screen TVs and John Deere lawn tractors.

There are, however, some tidbits of good news here as well. While Obama optimism is likely to bolster attitudes (we can't imagine the new administration being as hopeless as the last in marketing its overall economic renewal plans), reality is what will change minds of consumers, who hopefully will return to spending, but at a more responsible level, which means far less debt. Moreover, with consumers cutting back for so long, there is a growing pent up demand: after 12 months of distress, consumers are likely getting antsy to spend.

Indeed, with inflation low and commodity prices dramatically lower than middle 2008, the reality is that consumers are already getting more bang for the buck, particularly with gasoline, heating oil, and natural gas. Next, the stimulus package will result in immediate tax benefits. Now granted, the tax refunds afforded Americans in May and June of '08 didn't have quite the impact hoped for, it did have some. Americans should receive sizable refunds again this year. In addition, credit is un-freezing. Not only have mortgage rates dropped, but other credit lines should also loosen up.

But let's also remember that part of the problem here – American's incessant desire for acquisition, even by taking on greater and greater amounts of personal debt – has been part of this nation's shackles. The "great de-leveraging" – as some are wont to call it – may be ushering in a new age of personal responsibility, and greater savings. Imagine that.

Inflation. A slowdown in the economy went hand in hand with inflation numbers dropping dramatically in the second half of the year, as commodity prices – from oil, to metals and agriculture – cascaded down. Imagine oil, priced at a frightening $147 per barrel just seven months ago, has been hovering around $40, indicating just how extraordinarily volatile commodity prices can be.

With inflation falling each of the last three months of '08, and expected to remain in negative territory for a good part of the year, lower input costs will provide something of boon to corporate expenses. However, at some time inflation will threaten to resurge with the pickup in the economy and make itself a new thorn in the side of the Federal Reserve – but not this year. The good news here is, that at a time when people can afford less, prices have dropped. Keep in mind, however, that the enormous commodity increases in 2007 through mid 2008 helped catalyze the market slowdown to begin with, and may place further constraints down the road when global demand for key commodities once again increases.

Liquidity and credit. In an effort to stave off recession, beginning in mid 2007 the Federal Reserve finally began to drop rates, having raised them as recently as mid 2006. Since then, they have plunged rates down now to between 0-.25%, hoping to provide cheaper short term funding and lubrication for the credit machine. So far, however, these rate cutting measures may have provided some measure of psychological relief, but their net effects have not been as great as hoped.

Some credit markets have started to loosen up, however. LIBOR, in particular, used as a basis for mortgage pricing has finally come down. The bounty of cheap money is an important component to loosening up the credit strings. The money supply – the amount of available money floating about for growth and consumption -- has begun to increase, as hoped for by the Federal Reserve. The money supply measure economists refer to most, the M2 supply, has shown a rapid increase. It should be noted that many economists attribute the prolonged decline of the M2 supply in the 1930's as a big contributor to the Great Depression. Clearly this is not the case today.

Perhaps most importantly, the Obama administration has made it abundantly clear that banks and other lending institutions who receive taxpayer dollars will be accountable to making more funds available for borrowing individuals, businesses, and other banks. No more expensive commodes at taxpayer expense, insists the new President. In addition, the new administration is aggressively looking to corral and eliminate the various toxic assets held by the banks, which remains the source of the biggest part of the current credit crisis, just as it always has. The credit markets will look very different no doubt by the end of this year.

GDP growth in the US in 2008 turned sharply negative in the last quarter – estimated to be down perhaps 5% or more, after a negative third quarter. This broad-based contraction of the economy is expected to continue through the current first quarter of 2009. The projections suggest an improvement beginning in the 2nd or 3rd quarter, with positive growth actually beginning in the 3rd quarter of 2009. This assumes some significant impact from the Obama stimulus package.

Globally, GDP has also taken a significant hit. Euro zone economies slowed rapidly in the last two quarter of 2008, and are expected to follow the lead of the US through early 09. A recent report by the International Monetary Fund projects a global slowdown to 0.5% growth, the lowest in decades. While Japan hasn't taken quite the brunt that the US and Europe have, it along with other Asian nations are suffering both their own consumer demand reductions, credit tightening and the reduced interest in the US for their products. Developing nations, led by China and India, who have been averaging growth rates over 7.5% percent the last three years, will also be seeing sizable declines. The relative weakness in China's economy will continue to reverberate around the world, as China has been a major importer of materials and raw goods and a key global economic engine.

Some of the same components, however, that will help spur the US economy – namely the huge stimulus efforts – should help buffer the global economy as well. China and India are already embarking on massive stimulus efforts, and so are nations in Europe.

Stock prices are heavily predicated on anticipated corporate earnings. And while corporate earnings projections can be reasonably accurate during stable periods, it is precisely during these kinds of chaotic episodes that earnings projections lack much credibility. Example: earnings this past year have dropped over 30%, far more than analysts originally predicted, and there's no telling where they're going to be in the future. The recent bank earnings announcements keep reminding us that there's low, and…. lower.

On the other hand, as earnings have dropped dramatically (and as we all know, so have stock prices), this leaves investors with a current S&P 500 Price-to-Earnings multiple (P/E ratio) that's not only very reasonable – at just under 15 times trailing earnings – but one which has factored in a considerable amount of negative sentiment going forward. The earnings optimism that was still seen back in early and mid 2008 has long since vanished, obliterated by the chronic stream of bad news. That earnings have fallen so far, along with stock prices, suggests that we're nearing a bottom. Expectations are so low that they are likely to be met and exceeded. As earnings come up higher than anticipated, so too should prices.

Exports, one of the few bright spots in the US economy until mid-2008, has taken its toll amidst the global recession. Ironically, the strengthening of the US dollar over the last six months has made American export goods more expensive, which has added insult to injury for the global purchasers of US goods. The drops in global demand in general, as recession has spread will continue until the rest of the world pulls out of its own economic stress, which it will, although it could be well into 2010. *Manufacturing,* accordingly, continues to show some of its worst numbers since 1980.

December's Conference Board's Leading Economic Indicators (LEI) showed a slightly positive trend, a nice change in the direction from prior and sobering readings.

The upshot here is that while many negative conditions continue, the rate of decline of many of these key areas are slowing, and some important glimmers are becoming evident. We know the basic elasticity of economic cycles, but we also anticipate that the historic and aggressive government interventions will have substantial positive impact. Certainly there will be expected (i.e. inflationary) and other unintended consequences (wasteful and faulty efforts), but the impact will be profound.

Economic Outlook – The Salvation of the Stimulus

If the breadth and depth of this economic crisis has been remarkable, perhaps nearly equally so has been the willingness of many political and economic idealogues to set aside their pettiness and embrace one of the most far-reaching and comprehensive stimulus packages in history. While the Economic Stimulus Plan which offers up over $800 billion in a mix of tax cuts and aggressive spending programs, and presented recently by House Democratic Leadership (and now headed for the Senate) is expected to run into further partisan resistance, the general feeling is that it should pass largely intact.(See Appendix). This is in addition to the $300 billion recently released by Congress for the next phase of TARP, and also in addition to the nearly $8 trillion dollars of liquidity and guarantees being provided by Federal Reserve and Treasury through an unprecedented gamut of programs. (See the breakdown on the table in the Appendix.) This will provide a huge shot in the arm for an ailing economy. The mother of all financial crisis is about to meet the mother of all economic rejuvenation programs!

The $819 billion stimulus package – now called the American Recovery and Reinvestment Act of 2009 – and HR1 and SR1 – represents a huge investment (nearly 5% of GDP). $550 billion is slated for new spending programs, including massive infrastructure, green energy, healthcare and state aid. $275 billion is earmarked for immediate tax relief for middle class and small businesses. While smaller on a percentage basis than the $600 billion China recently announced, it's an enormous commitment. Congress will feel compelled to tinker and the final bill that gets signed will invariably be different – in just one week the size of the House bill went from 258 pages to nearly 650 pages! – but should retain the substance of the original.

Meanwhile, one of the key elements that created the global economic mess – the unclear amount of toxic sub-prime and other assets that remain on the books of many banks around the world – continues to debilitate. The original TARP – Troubled Asset Relief Program -- many will recall, was intended to remove those troubled assets and thereby free up the banking system. Unfortunately, the original scheme was too complex and the immediacy of the crisis forced the government to instead infuse dollars directly into the banks, as Europe was doing. Dealing with the troubled assets was kicked to the backburner under the Bush administration.

Now, thankfully, the Obama administration has made it clear that this issue is front and center, and several more realistic proposals are on the table that would separate the bad assets from the banks. Most likely using an approach similar to that of the Resolution Trust Corporation during the Savings and Loan crisis, the new program, probably part of TARPII, would purchase then sell those poor assets in the open market. The political environment seems very receptive to this approach, and we expect that this will be completed shortly. We believe this should have a tremendously positive impact on the global financial community, as banks can finally come clean and begin to trust one another.

Economists – while expressing diverse opinions as to the projected effectiveness of the stimulus package – seem to believe that the economy will begin to turn around in the latter part of the year, particularly with the combination of the various massive relief efforts in the US and around the world. And this makes sense: mortgage interest rates even now are low and heading lower, the credit markets are beginning to unfreeze and banks will be further encouraged (coerced) to make loans to other banks, people and businesses. Bad mortgage assets will be segregated and repackaged, and bank balance sheets will be shored up. Aggressive efforts will help to slow and turnaround the foreclosure crisis. While it will take time to rebuild the credit infrastructure – the various entities such as the now-defunct mortgage lenders that have been largely wiped out -- credit will increasingly flow. It seems that a majority of economists don't see an explosive economic rebound, but one nonetheless. We hold to this belief as well.

The Markets

While the economy is inclined to improve slowly, the markets historically explode up months before the apparent economic turnaround. Usually the steeper the drop (in this case over 50% from the November '07 highs), the steeper the rebound. If the economy begins its turnaround somewhere late in '09 or early '10, it's reasonable to believe that the markets could begin theirs in March of this year, at least from the cat-perch in this crapshoot.

Since late October and after a rapid 25% drop, the equity markets have been moving in a fairly tight sideways range. Given the depth and duration of this bear market decline to this point, we feel that markets by now factored in most, if not all of the expected bad news. While there is little clarity in terms of what is to come economically, it seems that expectations are largely for the worst in terms of pricing. Yes, there remains downside risk over the next few months, and there is a chance of retesting the lows of last November, but we feel that the upside potential is there, and growing.

Our Approach Now

We believe that looking back ten years from now we'll be looking at late 2008 and 2009 as ideal investing opportunities. For those with long term investment horizons and nerves of steel, that may turn out to be the best approach. Few fit that category, however.

On the contrary, for all but the most growth-oriented and long-term investment horizons, we are continuing to take a very careful market approach. For those looking to carefully enter the marketplace as we are, a strong position in cash and safe short term vehicles may be beneficial until longer term positions are taken. As the market sentiment may change very quickly and dramatically, those funds should remain extremely liquid. In the meantime, high quality corporate and government agency bonds and dividend paying stocks are a preferred means of income at this point. The current bubble in treasury bonds makes intermediate and long-term treasuries a dangerous road, and probably not worth the meager return, However, the credit spreads have made other investment grade, high yield bonds very attractive relative to their prices, and certain dividend stocks also are attractive. Oil prices are likely to stabilize and begin to move upward from here, but will continue to be volatile. Real estate – particularly commercial – remains problematic, both on the residential side with deteriorating home prices, and the commercial side, with difficult credit and a cloudy business environment. We continue to harbor concerns about the municipal markets, which were hit hard at times last year. While we feel the after-tax returns of municipals are very desirable relative to taxable treasuries, we recommend careful selection and oversight as municipalities will be struggling through this recession with an increase in defaults very likely. The State of California's economy bears witness.

Retirement investors who are making systematic investments should continue to make investments, following their asset allocations, but also look to adjust the asset allocations of their principal positions if their time horizons have changed.

We will continue to take a very cautious approach, meanwhile. As we see certain indicators – a stabilization of housing prices, a considerable loosening up of credit, a change in earnings sentiment, a change in market psychology, or a clear positive impact of the upcoming stimulus efforts – we will be encouraged to take a more optimistic position. This will invariably happen, but we will be proceeding carefully for now, but will remain to move quickly should we see it as appropriate.

Ron Stein

Several PS notes:
I wish to extend our appreciation for the generous input of Dr. Paul Kutasovic. It should be noted that Dr. Paul predicted the recession start in October 2007, when it actually began in December 2007. -- RS

We will be producing several forms of communications and newsletters over the course of the year. The Good Harvest News – the full (long) newsletter, will likely be produced twice each year, while News Updates will be provided over the course of the year. Email briefs may also be circulated as needed, all to keep our investors well-informed and hopefully, somewhat entertained. -- DJ

APPENDIX

I. Desperate Times, Desperate Measures, & Paradigm Shifts

I feel a need to offer up an offsetting perspective to the current economic despair, and one I feel is grossly overlooked. A system that appears to be functioning ok is not one to be tinkered with. A political-economic ideology operating during stable times is one difficult to change. Paradigm shifts can only take place during enormously stressful situations or crisis. Even Hoover's and FDR's ambitious construction efforts would have had little chance in quieter circumstances. Our current crisis means that a new way has the potential of emerging, and that new way could never have come about unless this nation was as seriously challenged as it now is. Otherwise, the politics simply wouldn't have permitted it, and the nation would have been doomed to unending incrementalism.

The Potential Paradigm Shift. So, for the first time in most of our lifetimes, certainly since the great ideologically change that began under Reagan and continued until January 20, a substantive change – a paradigm shift in fact – has the potential to rise from the current crisis. What might it look like?

An economy less based on financial engineering, and more based on real productivity. An economy more integrated with energy efficiency and resource utilization and climate change. An economy that seeks a healthy middle class and reduced class disparity. An economy that is predicated on an educational system that uplifts the economically distressed, and provides greater creative opportunity for all. An economy that incorporates a more efficient and fairer health care system that reduces the burden on business and reduces health cost stresses on the middle and lower classes. An economy that emphasizes science and research and provides all possible opportunities for responsible businesses to thrive. An economy backed by a government that provides much greater efficiency, responsiveness, and appropriate oversight to insure the economy's continued function. An economy that balances the best of free market capitalism's creativity and efficiency with the needs and aspirations of all of its citizens and with maximum stability and safety. An economy that can sustain.

So as we look back at the travails we've suffered over the last 15 months or so, let's consider the opportunity that we are now, finally after innumerable years, afforded.

II. We've Been Through This Before

The table below from Moodys.com indicates the projected recession compared to others over the last fifty years or so. Since World War II, this recession, if predicted until September 2009, will stand as the longest at 21 months. However, the twin recessions in '80 – '82 – which covered a period of 35 months -- probably felt much worse, and included a 20 month bear market. The recession in 1973, which lasted 16 months also included a 21 month bear market. The recession of 2001 really encompassed a much longer down market period, one that stretched almost 31 months, beginning in March 2000 and extending until October 2002. All of these experiences paled in comparison to those we experienced in the 1930s, '40s, and before.

U.S. Business Cycle Since World War II

		Duration in Months		Peak-to-Trough % Change		Jobless Rate, %		
Peak	Trough	Recession Peak to Trough	Expansion Trough to Peak	Real GDP	Nonfarm Employment	Low	High	Change, ppt.
Dec 2007	**Sep 2009**	**21**	--	**-2.6**	**-3.6**	**4.4**	**9.1**	**4.7**
Mar 2001	Nov 2001	8	120	-0.4	-2.0	3.8	6.3	2.5
Jul 1990	Mar 1991	8	92	-1.3	-1.5	5.0	7.8	2.8
Jul 1981	Nov 1982	16	12	-2.9	-3.1	7.2	10.8	3.6
Jan 1980	Jul 1980	6	58	-2.2	-1.3	5.6	7.8	2.2
Nov 1973	Mar 1975	16	36	-3.1	-2.7	4.6	9.0	4.4
Dec 1969	Nov 1970	11	106	-1.0	-1.4	3.4	6.1	2.7
Apr 1960	Feb 1961	10	24	-1.3	-2.3	4.8	7.1	2.3
Aug 1957	Apr 1958	8	39	-3.8	-4.4	3.7	7.5	3.8
Jul 1953	May 1954	10	45	-2.7	-3.3	2.5	6.1	3.6
Nov 1948	Oct 1949	11	37	-1.7	-5.1	3.4	7.9	4.5
Average		**10**	**57**	**-2.0**	**-2.7**	**4.4**	**7.6**	**3.2**

Sources: NBER, BEA, FRB, BLS, Moody's Economy.com

III. The Obama Stimulus Package – An Impressive Effort But is it Big Enough?

The current version of the package – called the American Recovery and Reinvestment Act -- now at $819 billion, is exiting the House of Representatives and heading over to the Senate. Unfortunately, any sense of bi-partisanship seems already to have been tossed overboard, for both legitimate and illegitimate reasons. What originally seemed to be a basic stimulus focused on infrastructure, state assistance, and tax reductions has morphed into something enormous in breadth. In fact, the proposed legislation, at approximately 250 pages a week ago is now well over 600. What additional changes will happen in the Senate is anyone's guess.

The program seems to retain the original dollar size of the stimulus proposed a month ago. Of course, the Republicans are looking to reestablish their *bona fides* regarding fiscal responsibility and small government, and they've begun with a partisan assault on this legislation, attacking most everything in the bill other than tax cuts and extension of unemployment benefits as more big government spending. On the other hand, the Democrats seemed to have thrown everything, from contraception to NEA funding into the bill, which only lends fodder to a partisan assault. The House vote was entirely along party lines, demonstrating just how quickly nothing changes.

Moreover, the concern may be that this bill does not do enough. Infrastructure needs dwarf the infrastructure spending in the bill, which amounts to about $90 billion, and which represents just of 15% of the $550 billion proposed not attributed to tax benefits. Understandably an immediate goal here is job protection and creation, and infrastructure has a slower impact than, let's say, extension of unemployment benefits, but more than $90 of infrastructure are begging for attention, and which could benefit the economy in the longer term.

Which brings us to a major concern. Getting a second bite of the apple is going to be increasingly difficult. If we need more than $32 billion in upgrading the grid, and more than $90 billion in essential transportation and infrastructure, why stick to the limit and the number the Obama transition team began with back in November? Let's get the real needed costs out on the table now.

By the way, one immediate concern of the bill from this side regards the focus of highway construction, projected to receive $30 billion approximately. We think this is poorly thought out. States typically are weak at determining transportation priorities, and both states and federal government have spent far more funds on building new roads than upgrading public transportation. A sustainable economy demands less reliance on the automobile, and more focus on developing centers and modernizing and making more efficient transportation systems. Spending priorities must change. Unfortunately, the new bill earmarks $30 billion for highways, bridges, and the like, and only $10 billion for public transportation. This is working backwards.

For a summary of the bill as passed by the House, we encourage you to go to:

http://appropriations.house.gov/pdf/PressSummary01-21-09.pdf

Meanwhile, the general and approximate breakdown is as follows:

American Recovery & Reinvestment Act - HR1

	Purpose	Cost, $ Billions
Energy & Infrastructure	grid, infrastructure	$32.0
	public housing, energy efficiency	$16.0
	weatherization	$6.0
Science & Technology	science facilities & research	$10.0
	broadband in rural and underserved areas	$6.0
Roads, Bridges, Transit & Waterways	highway & bridge repair and construction	$30.0
	federal & public energy efficiency	$31.0
	clean water, flood, environmental	$19.0
	transit and rail	$10.0
Education	school upgrades, repair, & technology	$41.0
	state education programs to avoid cutbacks	$79.0
	increase Pell grant $500	$15.6
	higher education modernization	$6.0
Healthcare	health information technology & efficiency	$20.0
	preventative care, treatment evaluation	$4.1
Employment & Training	increased unemployment benefits	$43.0
	continued COBRA and Medicaid benefits	$39.0
	foodstamps	$20.0
State Employment Relief	Increase Medicaid funding	$87.0
	law inforcement	$4.0
Tax Cuts	middle class & small business	$275.0

IV. The Massive Government Economic Emergency Effort

Think the stimulus is big? The US government is embarking on an precedented comprehensive loan and guarantee program, amounting to nearly $9 trillion dollars to bolster the vast economic and banking system, and begin the process of removing the toxic assets from the books of banks and institutions. Here's the jaw-dropping breakdown. The good news is that, unlike outright spending, most of these dollars stand to be recouped over time.

Pledged US Government Emergency Financial Outlays 2008+

Entity	***Actions***	***Amount***
Federal Reserve	Term Auction Facility, AIG and investment bank rescues, Commercial Paper, purchases of mortgage-backed securities, guarantee of bank debt	$4.9 trillion approx
Treasury	TARP, Fannie Mae, Freddie Mac, other supplementary financing	$1.4 trillion approx
FDIC	Guarantee of bank debt and increased FDIC insurance	$1.9 trillion approx
Federal Housing Administration	Mortgage refinancings	$300 billion approx
Economic Stimulus Act	Tax rebates	$170 billion approx
Source:	*Moody's Economy.com*	

Disclaimer: each investor has different needs. The information herein should not be used to direct investment decisions without assistance. Accordingly, no guarantees or recommendations can be made or implied in the above information.