globalview
Professional Experience, Unbiased Perspective

Market Update November 17, 2008

Recent market volatility compelled us to write another market update. These communications are intended to help our clients remain rational about long-term goals in the face of short-term uncertainty. If you have a problem accessing a link or reading this, please tell us and we can provide you with a copy in Adobe Acrobat PDF format. We appreciate your feedback.

Executive Summary

The market has already declined about as much as any time other than the Great Depression. Even if we face a monster recession like in the early 80s or 1973-1976, it seems logical to assume that the worst of the crisis (In the stock markets) is behind us. Investors from the beginning of 1973 until the end of 1976 would have squeaked out positive returns in the S&P 500, even after suffering huge losses through the end of 1974 <u>if they held steady</u> for two more years.

Percentage Total Return	1973-1974	1975-1976	1973-1976
S&P 500 (Total Return)	-37%	68%	6%
Buffet MOS managers (Total Return)	-33%	244%	63%

Value of $1000 Invested at Beginning of Period	1973-1974	1975-1976	1973-1976
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While we have already touched on the lows faced during the 1973-1974 panic, we are nowhere near what happened during the Great Depression when stocks fell by over 81% by the end of 1932. Moreover there are some very important distinctions to make. First, by 1929, the Dow Jones index had returned over 300% over the previous ten years (12% p.a. – per annum) and had returned 600% from 1921 to 1929. The return over the ten years prior to the peak in October of 2007 was about 191% or 6.7% p.a., substantially less. Second, as we entered the Great Depression, the US government was tightening money. Unemployment, at its peak during the Great Depression was over 25% in the US. Even pessimistic economists do not predict unemployment to rise above 9-10% in the US, nothing like the Great Depression and less than experienced during the recessions of 1975 and 1982. Now, the US and global governments are committed to do whatever it takes to make sure money is available. I believe we learned from this experience.

There has been a great deal of short-term pressure on the markets due to hedge fund redemptions that came due November 15. This phenomenon, combined with the stream of negative economic news, and an apparent change in position by Treasury Secretary Paulson, has forced the markets down. The experts whom we believe say it is ludicrous that we might face a Great Depression. Benjamin Graham, in a speech to the Senate in 1955, said he believed another Great Depression could be averted with government intervention. Instead, we believe we face a strong recession where financial stocks will continue to flounder, but where well-capitalized, undervalued companies will prosper. Ironically, stocks generally start to recover once a recession is recognized. To quote Warrant Buffett "***If you wait for the Robins, Spring will be over****.*"

Dr. Bruce Greenwald, a professor at Columbia Business School, believes we face a similar economic environment to that of 1974. If he is correct, then you don't want to miss the potential bounce back. After the panic in 1974, the return of the Dow Jones Industrial Average from 1975-1976 was 77%. The average return of a sample of margin of safety oriented managers (as illustrated in a paper by Warren Buffet) was over 240% over the next two years! The future is always uncertain and we cannot know our managers will repeat this stellar performance, but we continue to hear a chorus of excitement and believe we should heed our seasoned managers' advice. Professor Greenwald advises investors to have a steady, well-developed strategy and to stick to it, since history shows that <u>investors who try to change their strategies generally underperform fund managers by about 6% per year</u>.

Charles Du Vaulx and Chuck de Lardemelle (formerly of First Eagle funds) summarize this best:
"These times will also pass, and when they do, the investment landscape will undoubtedly be quite different from what we have known these past years and we believe it will be characterized by one paradigm; the well-managed, solid and above all, unleveraged businesses will be the survivors and the new "superstars" of the post-crisis world economy. It is these companies that we believe should command premiums to their current valuations, especially in a world where confidence rebuilding will take a very long time. It is our goal to craft well-diversified and carefully selected global portfolios which are being built around this new breed of tomorrow's survivors. In the meantime, however, we continue to ride the waves of this storm with resilience."

<u>Liquidity crisis:</u>
There is much evidence that supports our conclusion that the liquidity crisis is largely behind us. In his testimony to Congress, Treasury Secretary Paulson said ***"The actions taken by the Treasury, the Congress, and the Federal Reserve have clearly helped stabilize our financial system."*** There is evidence to support this - corporate bonds issued in October have risen in price over 10%; also, the spread between Libor and the Fed funds rate, which determines the cost of lending to banks, has fallen dramatically. While his performance may not have been ideal, the response has been swift and decisive and Mr. Paulson has been unafraid to look like an idiot in the face of changing facts.

Deleveraging has to occur across the financial sector, corporations, and the individual. It is likely that over the coming years the government will absorb much of this and that this will result in higher inflation (despite deflation in the short term), but this could be very painful for highly leveraged consumers. High inflation will be especially painful for holders of cash and

Treasuries. Government actions are likely to avert the possibility of a Great Depression, but will have other long-term consequences. Moreover, we should all pray that government spending is done wisely on projects that will have a return on investment. As Dr. Hussman has pointed out, the major cause of inflation is government spending on projects that do not show a positive return.

Economy – Recession or Depression:

New jobless claims in the United States reached 516,000, the highest level since the September 11 attacks; unemployment reached a 14 year high of 6.5% last month. Unemployment is expected to reach 8% over the coming year, some economists believe 10% is not out of the question. The German and Japanese economies are now formally in recession, with Euroland right behind. We expect much more bad news on the economic front. Again, we do *not* believe we face a Great Depression. The United States is fiscally sound and has an undervalued, intangible asset in its ability to tax corporate earnings. In a capitalist economy, bad companies fail and investors with capital purchase the failed assets and make lemonade out of the lemons.

Bill Ackman is an aggressive activist value investor heading Pershing Square Capital Management. He (as did Dr. Hussman) wrote a letter to the Treasury Secretary about the looming crisis back in 2004. In the link below, Bill describes how he and other managers used credit default swaps as a way to sell stocks, i.e. that he used these as an instrument to make shorting easier. Bill is very bullish on the US going forward. A new administration affords an opportunity for a fresh start and for the American people to become positive about the future.

Bill believes this is **"*the single best time to invest in my lifetime … the spread between value and price is the greatest it has ever been … Mr. Buffett has spent $50 billion in the last few months.*"**

See LINK to Bill Ackman on Charlie Rose 11/08

http://www.gurufocus.com/forum/read.php?1,38383

Dr. Irving Fisher, an active Economist during the Great Depression, believed the Great Depression was caused by over indebtedness. This, combined with low margin requirements of 10% (brokerage firms would lend $9 for every $1 invested) fueled the bubble—stock prices rose 600% from 1921-1929. Dr. Fisher says this sparked a chain of events:

1. Debt was liquidated and assets were sold under distress
2. The money supply contracted as bank loans were paid off
3. Asset prices fell
4. The net worth of businesses fell, precipitating bankruptcies
5. Profits fell
6. Both output (GDP) and employment fell (peaking at 25%)
7. Pessimism and loss of confidence was instilled
8. People hoarded money
9. Interest rates fell

By 1932, the market lost over 81% of its value. Benjamin Graham, during a testimony to Congress in 1955, felt that three primary drivers would reduce the probability of depressions going forward:

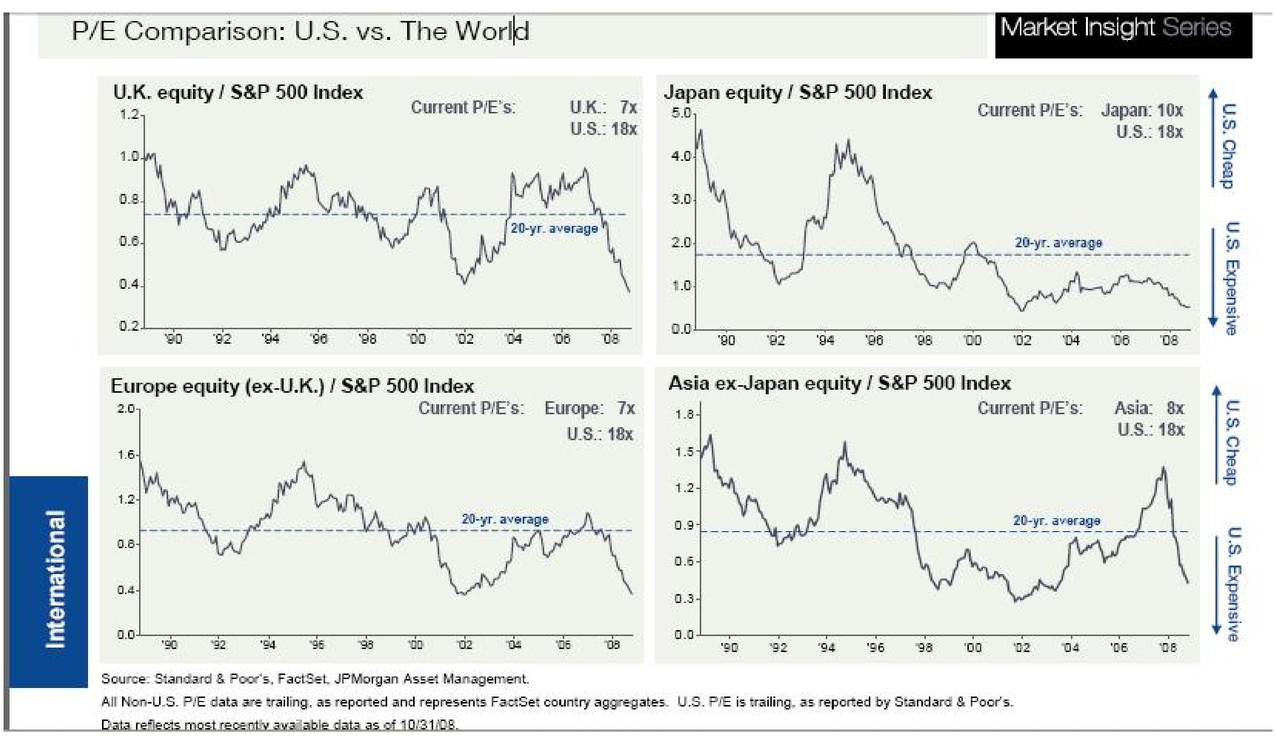
1. The vitality of businesses (we infer well capitalized businesses survive)

2. Government intervention (to support efficient market actions)
3. Inflation (liquidity injected by governments)

But there really may be no satisfactory explanation of why the Great Depression happened when it did. If these are a possibility in an unregulated capitalist economy, why haven't there been more? Milton Friedman argues that the Depression was a consequence of a sequence of blunders in monetary policy. In the run up to the Great Depression, policymakers probably overdid reigning in growth by raising interest rates too much and by not providing immediate liquidity into the crisis. In retrospect, Herbert Hoover wrote of the response during the Great Depression of 1929:
"The 'leave-it-alone liquidationists' headed by Secretary of the Treasury Mellonfelt that government must keep its hands off and let the slump liquidate itself. Mr. Mellon had only one formula: 'Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate." Treasury Secretary Mellonfelt said the following on panic: ***"'It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people."***

At this point it is crystal clear that the US and other governments are reacting swiftly and decisively to provide liquidity and stem this crisis. This is the appropriate response. Our view is shared by Jean Marie Eveillard of First Eagle funds from an update on October 13:
"… But we also believe firmly that such (government) action will be taken – no matter what – to prevent a 30s style depression or an extended Japan-style malaise. In that case we believe there is virtually zero change of either scenario, while also conceding that we will face difficult times nonetheless. A credit bust is never painless."

Moreover, as our managers have said, the situation is also different in Asia than in the United States. The US consumer makes up 70% of our economy, but only 55% of Japan's and about 35% of China's. Valuations are also much different.



The opportunity set worldwide is not the same.

<u>Market Outlook:</u>
Experts we trust believe the "fair value" of the S&P 500 is between 900 and 1100; they all concede that stocks generally sell above fair value. Jeremy Grantham sees a 20% sell off, or S&P 500 at 800 as necessary (we have already hit 818 at one point) and feels it is possible that the S&P 500 could overshoot to 600. John Hussman and Jeremy Grantham believe it would be foolish not to own stocks at this point. Bruce Greenwald says ***"these are exciting times."*** The bottom line is that we expect more volatility but cannot change our strategy at this point because the potential upside reward here is enormous.

<u>Bruce Greenwald on Value Investing:</u>
Bruce Greenwald holds the Robert Heilbronn Professorship of Finance and Asset Management at Columbia Business School. In his opinion we are ***"at the end of 1974, where good stocks are selling at three times sustainable earnings and stocks that normally wouldn't be sold at less than 20 times earnings are selling at 10 times earnings. These are exciting times. The short-term issue is that in the near term there will be a painful macroeconomic environment and we don't know how long it will last."*** In the link below, he ably articulates how cheap stocks are currently valued. This is the method used by most of our managers.

Dr. Greenwald also has some excellent advice for investors: ***"if you look at any mutual fund and you look at the average annual return – a dollar invested every year through the life of the fund – and then you look at the returns weighed by how much money was in the fund … the <u>difference in those two returns is 6 percent a year</u>. That's true for almost across every category of funds. What that means is investors are buying in exactly the wrong time and dumping things at exactly the wrong time. In this environment, the people who are dumping things are getting out at almost exactly the wrong time. What you want to have is a steady, well-developed policy you stick to."***
See LINK on Bruce Greenwald on Value Inesting 11/7/2008
http://biz.yahoo.com/usnews/081107/07_bruce_greenwald_on_value_investing.html?.v=1

Dr. Kenneth French is a Professor of Finance at the Tuck School of Business at Dartmouth. ***"The only thing you can be sure of about market timing is that people who try it lost." "if you can't handle the currently volatility, the smart answer is to shift your portfolio allocation more toward cash and bonds and less toward equities … and keep it there."***
See LINK to Kenneth French on market Timing
http://finance.yahoo.com/tech-ticker/article/128401/Don't-Try-to-Time-the-Market-Either?tickers=%5Egspc,%5Edji,%5Eixic

<u>History of Margin of Safety managers after 73-74 crisis:</u>
Warren Buffett gave a speech at Columbia Business School on May 17, 1984 and wrote a paper in the Columbia Business School magazine based on that speech. In this paper, Mr. Buffett showed the returns of five managers over from 1964 to 1983.

The important point here is that over the two-year period from 1973-1974 returns were similar to current returns. However, as the market turned into a weighing machine from a voting machine and value was recognized, these manages substantially outperformed the market. From 1973-1976, the MOS managers returned 63% above the initial value. The tables below show the total return and value of $1000 invested from the beginning of 1973 to the end of 1974, from the beginning of 1974 to the end of 1975 and from the beginning of 1973 to the end of 1976:

Year	Tweedy Browne Overall	Sequoia	WJS Ltd	Munger	Pacific Partners		Average		S&P 500 (including dividends)
1964			17.1	33.1			25.1		16.5
1965			26.8	6.0	21.2		18.0		13.1
1966			0.5	8.3	24.5		11.1		(10.4)
1967			25.8	37.5	120.1		61.1		26.8
1968	27.6		26.6	27.0	114.6		49.0		10.6
1969	12.7		(9.0)	21.3	64.7		22.4		(7.5)
1970	-1.3	12.1	(8.2)	(0.1)	(7.2)		(0.9)		2.4
1971	20.9	13.5	25.5	20.6	10.9		18.3		14.9
1972	14.6	3.7	11.6	7.3	12.8		10.0		19.8
1973	8.3	-24	(8.0)	(31.9)	(42.1)		(19.5)		(14.8)
1974	1.5	-15.7	(6.2)	(31.5)	(34.4)		(17.3)		(26.6)
1975	28.8	60.5	42.7	73.2	23.4		45.7		36.9
1976	40.2	72.3	29.4		127.8		67.4		22.4
1977	23.4	19.9	25.8		20.3		22.4		(8.6)
1978	41	23.9	36.6		28.4		32.5		7.0
1979	25.5	12.1	29.8		36.1		25.9		17.6
1980	21.4	12.6	23.3		18.1		18.9		32.1
1981	14.4	21.5	18.4		6.0		15.1		(6.7)
1982	10.2	31.2	24.1		24.0		22.4		20.2
1983	35	27.3	38.4		18.6		29.8		22.8
CAGR	19.6%	20.0%	17.4%	11.7%	25.1%		22.1%		8.5%

Note: This is compound growth of the returns averaged, not the average of returns

Source: Superinvestors of Graham-and-Doddsville by Warren E Buffet

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While past performance can never be a guarantee of future results. Two implications are clear. If this is like 1974, then investors who were invested in the S&P 500 over the entire period came out ahead, and investors in MOS managers came out substantially ahead!

Dr. John Hussman, often called a perma-bear, recently discussed the current market outlook in the context of long-term history and valuations. In a nutshell he believes the market will trade in a huge range of 25-35% as evidence develops pushing and pulling on investor expectations. However, this historically bearish investor has reduced his downside risk coverage because he believes the risk is worth taking. ***"Presently, observable evidence suggests that stocks are no longer strenuously overvalued, as they have been for over a decade (with the consequence that stocks have lagged Treasury bills over that period). Observable evidence also suggests that the washout last month was spectacular enough (and the breadth reversal substantial enough) to*** **allow for** ***– not ensure – a sustained advance."***
See LINK to hussman Weekly Update 11/8/2008
http://www.hussmanfunds.com/wmc/wmc081110.htm

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Over the next month and a half, we will be making some changes to taxable portfolios to take advantage of losses where possible to avoid capital gains distributions and reposition portfolios for more appropriate future growth. In the meantime, we encourage you to remain patient.

Global View Investment Advisors Team