

Van Sant & Mewshaw Inc.

Registered Investment Advisor

Common Sense Advisor ©

Volume 17 Issue 1

January 2009

MARKET MANTRA

Analysis/Commentary

Is it EOTWAWKI yet? For the benefit of our new clients we translate: “End of the World as we Know it!” No it’s not, it’s not been pleasant and it’s not over but it’s not EOTWAWKI, at least not for VSM clients. Certainly our portfolio’s are down, albeit not as much as the respective markets. But most importantly none of our clients were subjected to or suffered catastrophic losses. Indeed, our strict adherence to understanding and managing risk has served us well in the midst of this once-in-a-generation

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NEWS AND UPDATES

Year-Ahead Planning

To say the markets have been extremely volatile during 2008 is perhaps the understatement of the 21st Century. And as we stated in our commentary we don’t believe the bear market is over. It is one thing to understand that a long-term view is crucial to a successful investment plan. It is most emphatically another to not allow your emotions to rule your judgment. Hence, it is imperative to keep grounded with a periodic “reality check”. **Whenever you feel overwhelmed by the market’s machinations do not hesitate to call us.** We have resounding confidence that our investment methods and strategy, when adhered to, will be successful meeting our client’s needs and objectives. Also, now is a good time to review your portfolio and re-focus on your investment objective and strategy. One of the most common reasons for a portfolio to fail to meet its stated goal is miscommunication between the client and Investment Counsellor. If you have not done so recently please call to schedule a portfolio review.

Capital Gains and Loss Statement for 2008

IMPORTANT!!

The Capital Gains and Losses Statement is not included with the quarterly/annual VSM statements, it is sent out by request only. Please telephone VSM if you wish to receive this statement.

Required by the SEC

Rule 204-3(a) of the Investment Advisor Act requires all Investment Advisors to offer, annually, a copy of their Form ADV, Part II to all of their clients. Please consider this as our offer to deliver our most recent Form ADV, Part II. To request a copy call 410-825-8844 or visit the VSM website at vs-m.com.

Returns 2008

INDEX	YTD	1 YEAR
S&P 500	-38.50%	-38.50%
Dow Jones Industrial	-33.80%	-33.80%
Nasdaq	-40.50%	-40.50%
Russell 2000	-34.80%	-34.80%
Foreign Stocks	-45.10%	-45.10%
Enhanced Growth	-39.45%	-39.45%
Growth	-28.65%	-28.65%
Moderate Growth	-22.16%	-22.16%
Conservative Growth	-13.30%	-13.30%
1YR T Bill	+3.24%	+3.24%

For information about our Managed Account Services we can be reached at (410) 825-8844

Minimum Account Size \$150,000.00

market collapse. Our clients are subject to **systematic risk**, “good risk”; market risk. That is, risk that is knowingly taken in order to achieve higher returns than made available by the risk-free rate of return offered in a Treasury bill. Those that suffered catastrophic losses, from which they will not recover, allowed themselves to be subjected to **unsystematic risk**, by investing in things they didn’t understand or couldn’t explain. We don’t claim to have avoided these catastrophes by being smarter than others proffering investment advice. Quite the opposite, we avoided them because we were more ignorant. We were never smart enough to understand how it was possible to make money by lending to those you knew hadn’t a snowball’s chance in the Sahara of paying it back. We were and remain perplexed by SIVs, CDOs, CMO, SOMs, ARPs, and whatever. We were never able to comprehend how Wall Street was able to generate returns above the risk-free rate without taking more risk...we didn’t get **“it”**...and thankfully neither did our clients. We are confident in our ability to guide our clients through what lies ahead, in that we are aware of the profundity of our own ignorance, that is to say we are unburdened by the illusion of knowledge that have lead many of our contemporaries to make bonehead investment decisions. This time last year we offered our best guess for 2008 by saying, “The markets have been extremely volatile during 2007 and by all indications will continue to be so in 2008.” Little did we suspect that we were about to experience a global market collapse brought about by a tsunami of forced liquidations. So far the period from the market peak on 10/9/2007 until the present market bottom set on 11/20/2008 has proven to be the fifth worst market

decline in history (see table at the bottom of this commentary). Moreover, the resultant effect left no asset class, save U.S. Government bonds, unscathed. In essence it didn’t matter where you had your money invested you suffered. What proves to be more startling is a review of longer term returns. Using **one, three, five** and **ten** year periods the compounded annual returns are respectively: **Stocks** (S&P 500 Index); -38.50%, -7.84%, -2.01%, -1.54%, **Balanced Index** (60% stock 40% bonds); -20.46% -2.30%, 1.36%, 2.25%, **International Equities** (EAFE Index); -45.10%, -6.34%, 1.91%, 2.60%, **Bonds** (Lehman Bond Index); 3.91%, 5.23%, 4.54%, 5.31%, **Commodities** (Dow Jones AIG Commodities Index); -36.68%, -11.14%, -1.25%, ten year not available. Simply stated there has been no and at best paltry returns for the long term investor. It’s for sure that stocks are no longer overvalued as they have been most of the previous decade. In fact stocks have reached a level of cheapness that hasn’t been seen since the early 1980s and can be expected to deliver total returns annually of 10% or better over the next 7 to 10 years. That’s the good news. The bad news is that we most likely are not near a bottom and certainly not at the start of a bull market. It is possible that we are headed lower before this bear market ends, to an extreme undervaluation of equities. But before we reach a possible low, the probability for a soaring rally of 20%-25% is very high. Even after the 1929 crash with unemployment reported at 25% the S&P 500 doubled following the market low of 1932. If this happens it will give us the opportunity to rebalance the portfolios in accordance with our risk reward scenario.

FIVE WORST MARKET DECLINES IN HISTORY

TOTAL LOSS	TOTAL LOSS	DURATION	ANNUALIZED RETURN THROUGH 2007**
04/17/1930—07/08/1932	-86.0%	813 Days	9.9%
03/10/1937—03/31/1938	-49.1%	386 Days	10.7%
01/19/1906—11/15/1907	-48.5%	665 Days	No Data
09/03/1929—11/13/1929	-47.9	71 Days	9.7%
10/09/2007—11/20/2008	-47.0%	408 Days*	?
Average of 10 worst declines	-49.7%	592 Days	—
01/01/1926—12/31/2007	—	—	10.4%
01/01/1945—12/31/2007	—	—	11.8%

*THIS DATA UTILIZES THE CURRENT LOW ON 11/20/2008. THIS MAY OR MAY NOT BE THE ULTIMATE LOW FOR THIS DECLINE.

**--ANNUALIZED RETURN DATA IS BASED ON THE START OF EACH YEAR, BEFORE THE DECLINE, THROUGH 12/31/2007.

SOURCE: BBC NEWS—BEAR MARKETS: WALL STREET’S WORST

NOTABLE QUOTES

“Thanks to the current panic many Americans have learned that the experts who advise them what to do with their savings are, at best, fools. Merrill Lynch & Co., Morgan Stanley, Citigroup Inc. and all the rest persuaded their most valuable customers to buy auction-rate bonds, telling them the securities were as good as cash. Those customers will now think twice before they listen to their brokers ever again. Many, I’m sure are just waiting to get their money back from their brokers before they race for the exits and introduce themselves to Charles Schwab. Bank of America Corp. will soon discover that the relationship between Merrill Lynch and its customers isn’t what it used to be, but Bank of America’s loss is America’s Gain.” (*Bright Side of a Total Financial Market Collapse*, Michael Lewis, Bloomberg, 9/18/08)

“With retirement accounts tumbling and millions of homeowners struggling to pay their mortgages, a realization is dawning on many Americans: The banks, brokerages firms, insurance companies and other players in the financial-services industry have failed them. Thirty years ago, a typical consumer had a fixed-rate mortgage, a life-insurance policy, a bank account and an employer-paid pension plan. Nowadays, that same consumer may have a payment options adjustable-rate mortgage, a 401(k) retirement-savings plan, a home-equity line of credit and perhaps even a health-savings account instead of traditional employer-sponsored health insurance. In the process, risks previously borne by big banks and employers have been placed squarely on the shoulders of consumers. Individuals increasingly bear the risk of interest-rate fluctuations, rising health-care cost, stock-market gyrations and outliving their retirement savings.” (*Consumers*

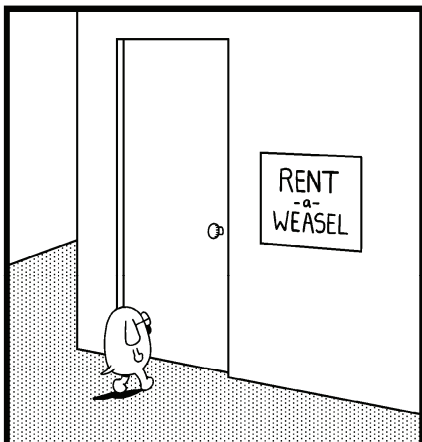
Say Wall Street Failed Them, Eleanor Laise, WSJ, 11/29/08)

Greenspan refused to let people fail. And so we’ve had no failure in the financial community and now we’ve spent trillions of dollars bailing out Wall Street for their mistakes and that’s damaging the whole economy; 300 million Americans to bail out a million people and their failures. This is not good for America. We’re damaging the system. We’re weakening the system dramatically. Why are we bailing out Citibank? Why are 300 million Americans having to pay for Citibank’s mistakes?...There are many banks, many brokers, many homeowners who’ve been sitting there, doing what they were supposed to do...Now instead of being rewarded, they’re being punished. (*Interview with famed investor Jim Rogers, Bloomberg TV 11/25/08)*

“WASHINGTON- A panel of top business leaders testified before Congress about the worsening recession Monday, demanding the government provide Americans with a new irresponsible and largely illusory economic bubble in which to invest. “What America needs right now is not more talk and long-term strategy, but a concrete way to create more imaginary wealth in the very immediate future, said Thomas Jenkins, CFO of the Boston-area Jenkins Financial Group, a bubble-based investment firm. “We are in a crisis, and that crisis demands an unviable short-term solution” (*Recession-Plagued Nation Demands new Bubble To Invest In, The Onion, 7/14/08)*

DILBERT BY SCOTT ADAMS

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Passive Portfolio Allocations
December 31, 2008

FUND	ENHANCED GROWTH	GROWTH	MODERATE GROWTH	CONSERVATIVE GROWTH	RETURN 2008
U.S. Stocks Large Cap	65.00%	50.00%	40.00%	30.00%	-37.02%
U.S. Stocks Small Cap	15.00%	10.00%	8.00%	5.00%	-36.07%
Foreign Stocks	20.00%	15.00%	12.00%	5.00%	-44.10%
U.S. Bonds	0.00%	25.00%	40.00%	60.00%	+5.05%
	—	—			
Return Thru 12/31/2008	-39.45%	-28.65%	-22.16%	-13.30%	—

THE PURPOSE OF PASSIVE ALLOCATION

Passive Allocation reflects a logical, static, strategic asset allocation for a hypothetical long-term investor who is not using active asset allocation. It is based on our evaluation of the historical long-term risk and return relationships of the asset classes, and what we consider to be realistic and reasonable expectations going forward. It is the starting point for our active asset allocation process.

The passive allocation is the asset allocation that we will implement when our conviction level about any specific asset class is not high enough to justify changing the asset allocation mix. It gives us a sensible long-term allocation, based on sound research. It gives us a constant frame-of-reference against which to measure decisions. For example, if our research shows small cap growth stocks are at historically undervalued levels, we must decide what they will replace in the portfolio and how far from passive we will stray. This will be a function of our confidence and the impact on the portfolio's risk and return potential. The permanent frame-of-reference imposed by the passive allocation increases the odds that we will consistently apply our methodology. The passive allocation will serve as a benchmark against which to measure our value added.

Passive Portfolio Allocation Historical Risk/Return

PORTFOLIO TYPE	RISK LEVEL 12 MONTH LOSS THRESHOLD	TEN-YEAR AVERAGE RETURN	WORST 12 MONTH ROLLING RETURN 1996 THROUGH 2007
Enhanced Growth	-20%	5.94%	-27.11%
Growth	-15%	5.72%	-18.30%
Moderate Growth	-10%	5.51%	-12.88%
Conservative Growth	-5%	5.00%	-6.96%

Passive portfolio results reflect only hypothetical returns and may differ significantly from results achieved for actual managed accounts. Passive portfolio results reflect reinvestment of dividends, other earnings and the deduction of fund expenses and management fees. Complete descriptions of accounts and transaction history is available upon request. Van Sant and Mewshaw, Inc makes a good faith effort to highlight and summarize certain economic, market, and other data to assist their clients in structuring investment portfolios. This report should not be construed as advice meeting the particular needs of any investor. Investors are advised that past performance is no guarantee of future results. Historical data provided by Morningstar; beginning in April 1996 through December 2007