

NAVIGATOR

The Newsletter for the Clients of TGS Financial Advisors



Moscow Rules

by James S. Hemphill, CFP® ChFC CIMA

“There are three kinds of people in the world, those who can count and those who can’t.”

— Warren Buffett

There are also three kinds of investors, those who buy low and those who don’t.

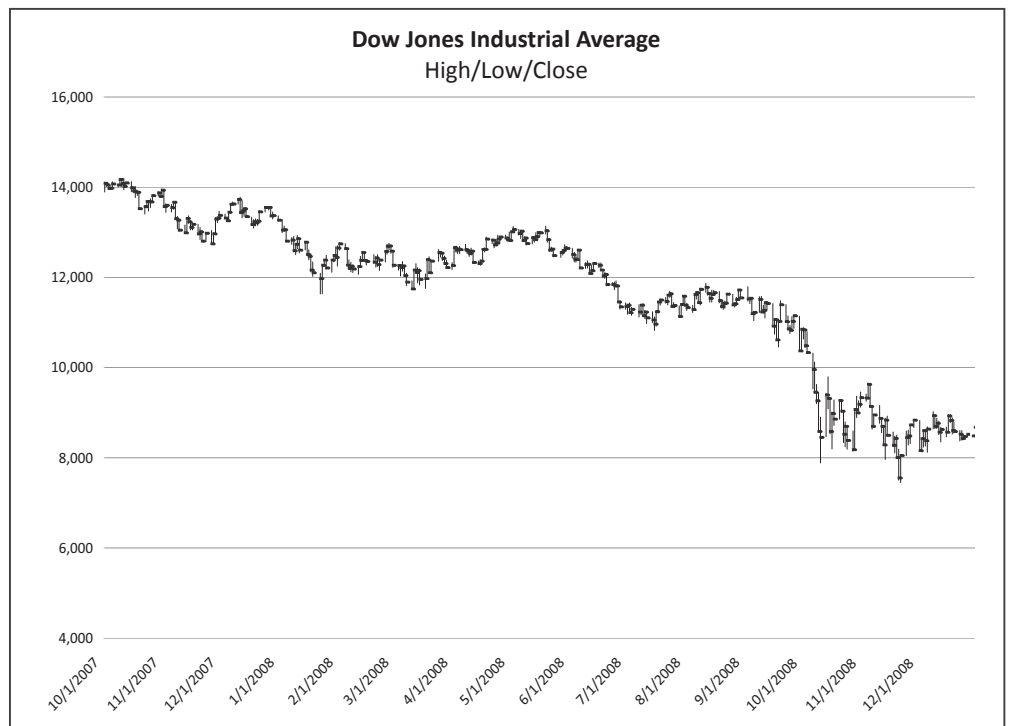
Many investors don’t buy low because they lose their nerve in bad markets. Some even panic and sell.

A second group, including most professional investors, fully intends to buy as soon as the market bottom is reached. They understand in theory that they should buy cheap. They *intend* to invest when the market is low. *But they never actually buy.*

The third group is those who buy stocks even when the news is bad, even in the face of de-

pressing news, lousy trailing performance, apparently dismal prospects, and (this is the key point) without knowing or caring where the exact market bottom is.

So the first two groups, those who are afraid to buy and those who intend to buy low but don’t, are really one group — the group that misses the opportunities created by any bear market.



Why don’t they buy? Because they want two things: certainty that the market bottom has been reached, and comfort with the direction of the economy.

The investment world is full of people who intended to buy when the market was cheap, but who insisted on

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definitive evidence of a market bottom, which is never there when you need it – when the market is actually at the bottom, amid the inevitable chaos, uncertainty and negative prognostications.

When we think through our reaction as investors to this past year’s devastating bear market; to our wish to take advantage of lower prices while finding reassurance about future prospects, it translates as follows: “I want to buy at cheap prices on good news.”

After thirty years advising investors, I can state with assurance that this never happens. Our choices are always between good news and high prices, or bad news and low prices. Buying low always involves a leap of faith, ignoring the current bad news while assuming that the future will be rosier. Buying super-cheap means buying on despair, amid panic, in an environment of apparent impending catastrophe. *Buying at or near the point of maximum opportunity requires an affirmative act of enormous courage; a choice to step across the abyss with no immediate and certain reward on the other side.*

In the past, such choices have often been richly rewarded. Let me tell you my favorite story about John Templeton, arguably the greatest investor of the last century. It was 1932, in the early stages of the Great Depression. The news was grim. American businesses were failing, unemployment was over 20% and rising, drought had hit the southern plains. The stock market was down over 80%.

Templeton at that time was a young man working on Wall Street. Since the day they were married, Templeton and his wife had saved half of every paycheck. Now he was ready to put those savings to work. He called his stockbroker and issued the most famous buy order of the 20th century: “Buy me 100 shares of every stock on the New York Stock Exchange selling below \$2 per share.” The broker called him back the next day. He’d purchased 100 shares of every sub-\$2 company that was not in bankruptcy. Not good enough. Templeton sent him back to the exchange with orders to buy the rest of the cheap stocks, the ones already in bankruptcy.

You can see where this story is headed. The market rallied and Templeton became independently wealthy at a young age. He went on to huge success as an investor and founder of the Templeton Funds, was knighted by Queen Elizabeth and established the Templeton Prize for Religion.

As Paul Harvey would say, here is the rest of the story. At the same time Templeton was making his famous purchases, a generation of ordinary investors was getting out of the stock market, convinced that stocks were a fraud and a fool’s game. Not only did they miss the subsequent recovery in the markets, in many cases they also poisoned the minds of their children and grandchildren against the surest long-term path to riches – owning the common stocks of successful American corporations.

Table of Long-Term Returns

Historic Returns of Asset Classes ¹ From 1926 to 2008		
Asset Class	Geometric Mean Return	Real (Inflation-Adjusted) Return
Large Company U.S. Stocks	9.6%	6.5%
Long-Term Government Bonds	5.6%	2.5%
U.S. Treasury Bills	3.7%	0.6%
Inflation	3.1%	0.0%

¹Source: [Morningstar Ibbotson SBBI Classic Yearbook Market Results for Stocks, Bonds, Bills and Inflation 1926-2007](#)
Additional Data & Formatting by TGS Financial Advisors

As investors, we must always make choices amid uncertainty. The greater the uncertainty and psychological difficulty of the choice, the more important it is to our long-term financial security. Conversely, the greater the opportunity, the greater the temptation to panic and sell.

Speaking of panic, on October 10, 2008 something very unusual happened at TGS Financial Advisors. Four of our clients panicked and sold everything on the same day. This almost never happens to us. We literally had not had a single client sell out this century, never mind four in one day.

Two of these panicked clients were John and Mary (not their real names). The interesting thing about their sell decision is that they wanted to do the same thing in September of 2002, almost exactly at the low of that prior bear market. Back in 2002, I was able to talk the wife out of selling. This time around the husband was adamant. He sold at the lowest closing price in more than a decade, probably among the lowest prices we will ever see in our lifetimes. He wired his money to the bank, from which he intended to withdraw it and put it (quite literally) in his mattress.

At the exact moment John and Mary were on their way out, Warren Buffett, America's richest man, was on his way in. Buffett negotiated a \$5 billion investment in Goldman Sachs, and wrote an op-ed piece in the New York Times titled, "*Buy American. I am.*" Understanding that we can never predict the future with certainty, *what do you think the chances are that John and Mary were right and Warren Buffett wrong?*

We are now in the second once-in-a-generation bear market of the last decade, amid an atmosphere of pervasive gloom and despair. We can't change the economy, the disconnect between Washington policy and Main Street values, or the short-term direction of the market. We can't know the date or the price of the final market bottom.

All we can do is decide if we are going to be on the same side of the bear market as Warren Buffett today and John Templeton back in the 1930s, or on the side of John, Mary and a million other despairing individual investors.

So this is it. The great buying opportunity of our generation. Maybe the goods already on sale will be marked down further. Maybe a lot further. Perhaps 2008's 40%-off sale will become 2009's 75%-off sale. On the other hand, the market may rally in 2009 and begin another long-term bull market.

In the old days of the Soviet Union, when Communism ruled and consumer goods were scarce, the oppressed population lived by "Moscow rules." Any time they saw a



queue at a store (*any* store) they got in line and bought. They bought whatever was on sale, whether they needed it or not. If they could not use it, at least they might be able to trade a fur hat for five pounds of lard later on.

Ubër-shopper and author of *Born to Shop* Suzy Gershman adapted Moscow rules for ordinary commerce. Her rule is, '*if you see merchandise you like and it is on sale, buy it.*' Don't wait for the lowest possible price, or you will miss the deal.

Table: Bear Market Recoveries

Date of Market Low	Bear Market Decline	Subsequent Recovery		
		1 Year	2 Year	5 Year
June 1932	-84%	117%	108%	228%
February 1974	-43%	32%	56%	60%
August 1982	-17%	53%	38%	183%
February 2003	-42%	37%	43%	62%
2007-??	??	??	??	??

Maybe today's deep discounts will persist until Memorial Day 2009, or until Labor Day, or even until the mid-term elections in 2010. But at some point, the markets will turn up. History suggests that a large component of the total bull market will occur in the first months of the recovery. If you aren't already invested, you may miss it.

Moscow rules. The market is on sale. Buy now, and don't wait.

THE ELECTION AND YOUR MONEY

by James S. Hemphill, CFP® ChFC CIMA

Eight years ago I wrote another column titled, The Election and Your Money. In that piece I noted that, while I would be dancing at George Bush's Inaugural Ball, I expected investors would have rough sledding on his watch. That prediction proved to be correct. George Bush's eight years have been the worst period for investors in a generation.

Poor George Bush. How often have we heard about the great economy that Bush inherited, and how he wrecked the economy and turned the surplus into record deficits?

Bush is perhaps more guilty of bad timing than economic incompetence. In reality the bull market ended in the last year of Clinton's presidency, Bush's inauguration took place ten months into the worst bear market since the Great Depression, and eight months later we suffered the worst foreign attack on America soil in our history. No matter. History suggests that Presidents get praised or pilloried based on economic events during their watch, pretty much regardless of their own responsibility for the good or bad news.

We have suggested in prior Election and Your Money articles that long-term economic success rests on three aspects of economic policy – a sound currency, a growth-friendly tax structure, and commitment to free trade. Before giving our report card on the incoming Obama administration on those measures, let us add two more measures we have not previously included: the overall size of government as a component of GDP and the regulatory climate. So what do we think about Obama's incoming administration?

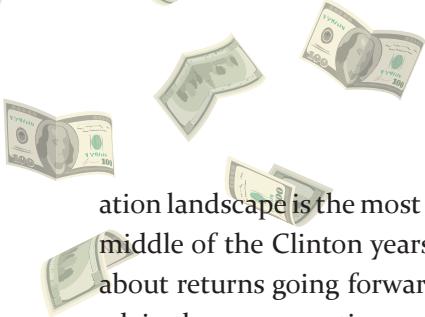
Obama has put together an economic team of centrist Democrats, including several of the Clinton administration's senior advisors, as well as noted inflation-hawk Paul Volcker. Obama's wish to preserve a sound currency appears sincere. Yet the amount of stimulus provided by the Federal Reserve is already without precedent, and we greatly fear an inflationary crisis once we get past the current severe recession.

Obama's tax proposals look to be more growth-friendly than expected, mostly because of the need to get Senate Republicans on board with his stimulus package. Obama ran for the Democratic nomination as an opponent of free trade to win union votes, but his appointments appear to indicate that he will be trade-friendly in practice.

On the issue of size of government, we are in a desperate position before Obama even takes office. Both contemplated spending and the size of the 2009 deficit are enormous. On this issue we are not optimistic. On the regulatory front, expect a massive increase in the scope of government power. The biggest question is whether increased regulation will primarily address the Wall Street excesses that led to the global financial crisis, or go well beyond needed reforms and broadly constrain the effective operation of our free enterprise system.

Barack Obama appears to be taking office during a time of profound crisis. I believe this appearance is somewhat deceiving. While bad news dominates the headlines, good news (an economic recovery) may well be closer than we expect. Over the next two years, we suspect that a record amount of easy money and a trillion dollars of expected combined spending and tax cuts will have the desired effect, and that the economy may rally more strongly than most observers expect.

Over all this we must overlay valuation. With the market down over 50% at the November 2008 low and already trading at the lowest prices since 1998, we think the valu-



ation landscape is the most favorable it has been since the middle of the Clinton years, and we are quite optimistic about returns going forward. In both 2000 and 2004 we advised a more cautious approach to investing. Today, contemplating those nasty Democrats in control of the Presidency, House and Senate, this Republican advises a more aggressive approach, choosing stocks over bonds and staying fully-invested.

We wish our new President well. We hope that his Administration will remain close to the vital American center, and that it will tackle our problems wisely and effectively. Meanwhile, you have entrusted us with your money, and that is a responsibility we take very seriously. We promise to mind the store and keep our eye on the ball, without fear, favor or partisan bias, after Inauguration Day on January 20st just as before.

SOUP-ERSTITION

There is an Italian tradition that if you eat lentils on New Year's Day you will be prosperous all year long. Every year since 1982 Jim Hemphill cooked and consumed lentil soup on January 1st. The result: strong markets and prosperity for most. Until 2008. This past year the Hemphills spent New Year's in South Africa, at a hut in Kruger National Park with limited kitchen facilities. No lentil soup, and as a result the worst bear market in more than sixty years.

This New Year's Day, Jim made two pots of lentil soup, one vegetarian and the other with two kinds of turkey sausage, and ate much more soup than was wise, given his January resolution to lose weight.

We are optimistic about this year's markets.



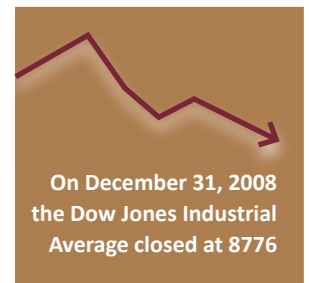
AND THE WINNERS ARE...

While we continue to maintain that no one is able to reliably predict the direction of the markets in the short term, clients who attended our *Market Update* presentations were given a chance to win a prize by correctly picking the closing price of the Dow Jones Industrial Average on December 31, 2008.

The Dow closed at 8776.39 on December 31. Our winner, Kent Snell (8753), nosed out Brenda Esopi (8800) to win first prize by less than one point. Noel Melhorn (8700) placed third. Congratulations to our three winners!

Our little market-prediction contest also offers an instructive example of the impact of psychology during turbulent market environments. One of our clients, who has a technical background and is a long-time student of the markets, attended two of the meetings. At the first session, on the chaotic day of November 22nd, when the Dow closed at 7552, he predicted the Dow would finish the year at 6500. Three weeks later, on December 11th, with the Dow a thousand points higher (8565), he attended a second update session. This time he predicted a year-end close of 10,000.

As we discussed in our *Market Updates*, in this sort of market environment our minds turn short-term trends into long-term certainties. When the markets are going down, we believe they will continue to decline; when markets are up, we are convinced they will rise in perpetuity.



On December 30, 2008 TGS Financial Advisors held a *Market Update* webinar to discuss the issues surrounding the recent unprecedented stock market volatility.

Please feel free to call us at (610) 892-9900, (800) 525-4075 or e-mail shauna.pelkey@tgsfinancial.com to request a copy of the Market Update recording.

TEAM NEWS

Vincent and Jill Barbera are excited to announce that they are expecting their first child, a baby boy, in April.

In November of 2008 Thomas Rylko passed the third exam in his Certified Financial Planner™ education program. He is currently working on his fourth course.

In November of 2008, Vincent Barbera was elected to the Board of Directors of the Philadelphia Chapter of the Financial Planning Association.

Three interns, Daniel Stefan, Jack Hemphill and Andrew Gerrity, joined the TGS team over the winter holidays. Daniel is a Junior Business and Economics major at Lafayette College in Easton, PA. Jack is in 6th grade at Westtown School in West Chester, PA. Andrew is a sophomore at Friends School in Baltimore, MD. He hopes to attend Georgetown and study business.

Are We Missing Something From You?

In December of 2008 the *Daily News* broke the story that the Postal Service in Southwest Philadelphia had 19 tons of "waste" mail hauled away and destroyed. Some of that "waste" included first class mail and business-reply envelopes.

If you believe that information you sent to us may not have been received, please contact us.



TAX UPDATE 2009

In December of 2008, Congress approved legislation that includes a **one-year suspension of the required minimum distributions for 2009 taxpayers** who are 70½ and older. The 2008 requirements remain unchanged.

FISH STORY

The art nook in our reception area had remained empty since we moved into our new digs in January of 2007. While in Bali, Jim Hemphill purchased a painting for this space. One day in December we all walked into the office and saw *Fish* hanging on the wall.

Fish is the work of famous Balinese artist Ngurah KK, who painted the World Wildlife Fund's sea turtle logo in 1983 and also created Unicef's 1996 Christmas card. The initial reaction to *Fish* was not enthusiastic. As receptionist Carol Lotfi noted, "It doesn't seem like a *happy* fish."



Should *Fish* stay or go?

Like the British sailors, we like what we are used to. So before we get too comfortable with our scary scaly friend, we need your help to determine if *Fish* should stay or go.

Please call us at (610) 892-9900, (800) 525-4075 or e-mail shauna.pelkey@tgsfinancial.com with your vote, either *stay* or *go*. We will disclose the verdict in the *Spring Navigator*.

TAX FILING

Original 1099s are mailed to clients by Raymond James by January 31st. However, mutual fund companies frequently send us corrected information. Corrected 1099s should be sent to you by February 28th. Interest and dividends from certain payers may not be reported to Raymond James until as late as March. We therefore recommend that you not complete your taxes until the end of March.

2008

CLIENT Q&A

Paying investment fees and transaction costs is painful in this bear market. Can't something be done to reduce these costs?

We are actively pursuing three initiatives to reduce our clients' costs.

1) In 2008 we realized capital losses on securities in taxable accounts sufficient to offset realized capital gains, either gains from prior sales of securities or capital gains distributions from mutual funds. In many cases we also realized additional losses, in order to allow clients to deduct \$3,000 of losses against ordinary income and save money on their 2008 income tax bills.

2) We are switching from retail-class mutual funds to institutional-class shares, which charge lower annual fees and expenses. For example, we have sold most of our positions in PIMCO Total Return Fund Class A and purchased shares in PIMCO Total Return Fund Institutional class, reducing the expense ratio our clients pay from 0.90% to 0.46%.

3) We are putting in place the paperwork needed to establish a TGS Financial Advisors wrap program. Once this program is in place, all buys and sells in wrapped accounts will be free of Raymond James transaction fees.

What will happen to those transaction fees?

Once the wrap fee program is in place, TGS Financial Advisors will absorb transaction charges.

If you have a friend, family member or colleague that you think may be interested in the investment and financial planning services that we provide, please don't keep us a secret. Our business grows through referrals.

We are grateful for your trust.

BOOK RECOMMENDATION

Reviewed by Shauna Mace

This quarter we are responding to the prevailing gloom by going classic, light and cheerful in our book recommendation.

Thousands of miles from Wall Street, join author and vet James Herriot on his real life journey through the English countryside, one animal at a time. As a recent veterinary graduate during the Depression, Herriot is ecstatic to land a position as an assistant veterinary surgeon. His adventure begins as soon as he steps out of the car to meet his employer and fellow vet Mr. Siegfried Farnon.

There is no shortage of (often hilarious) stories, from Herriot's interactions with the local farmers and their beasts of burden to neighbors and their beloved pets. My favorite patient is a spoiled Pekingese named Tricky Woo, whose diet consists of boiled chicken and cake, and who affectionately knows the vet as "Uncle Herriot."

All Creatures Great and Small
by James Herriot

Quote FOR THE QUARTER

"Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts.

Warren Buffett
"Buy American. I Am." New York Times
October 17, 2008

The Markets at a Glance (ending December 31, 2008)

INDEX	VALUE	ANNUALIZED RETURN		
		One Year	Five Year	Ten Year
Dow Jones Industrial Average	8776.39	-31.9%	-1.1%	1.7%
Standard & Poor's 500 Stock Index	903.25	-37.0%	-2.2%	-1.4%
Morgan Stanley Europe, Australasia, and Far East Index	1237.42	-42.7%	1.4%	-1.3%
Lehman Brothers U.S. Aggregate Bond Index	—	5.2%	4.7%	5.6%
Lehman Brothers Municipal Bond Index	—	-2.5%	2.7%	4.3%
Six Month Certificates of Deposit	—	3.0%	3.8%	3.8%
Inflation (Consumer Price Index)	—	-0.1%	2.7%	2.6%

Inclusion of these indices is for illustrative purposes only. Keep in mind that individuals cannot invest in any index, and index performance does not include transaction costs or other fees, which will effect actual investment performance. Individual investors' results may vary. Past performance does not guarantee future results.

MARKET COMMENTARY

The fourth quarter of 2008 saw one of the worst three-month declines in stock market history.

The Dow Jones Industrial Average dipped below 8,000 twice in the third quarter. On October 10th we experienced the biggest intra-day point change in history (from down 8.1% to up 3.8% to close down less than 2%). The following Monday, October 13th saw the biggest one-day percentage rise since the Great Depression. Mid-November saw a retest of these market lows, with a new Dow closing price of 7,552, the lowest since 2002.

As we consider the global financial markets, we see the most severe price dislocations of our careers. Diversification has provided little protection, as assets from Real Estate Investment Trust to foreign stocks to

Treasury Inflation-Protected Securities (TIPs) have all declined by unprecedented amounts. For the first time since the 1950s, the S&P 500 dividend yield exceeds the yield on the ten-year Treasury bond.

There is a time in every severe bear market when a prudent investor must make a leap of faith in the face of uncertainty, and act based on the rational but unprovable belief that the stock market will recover. We remain stubbornly optimistic about both the American economy and the long-term investment benefits of owning equities.

As always, we are making our decisions based on economics, value, and relative price, and not based on either investor psychology or trailing performance. If the world is not ending, and we are not about to endure a ten-year depression, then it appears to us that lots of quality assets are dirt cheap. *We are buying.*

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from TGS Financial Advisors. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.

Please remember to contact TGS Financial Advisors if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services. Please also advise us if you would like to impose, add or modify any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement discussing our advisory services and fees remains available for your review upon request. You should discuss any tax or legal matters with the appropriate professional.