

January 23, 2009

PATHWAY FOR 2009

Let's start with a quick review of 2008. Understated, the year was the most difficult since the 1930's with the S& P 500 stock index declining 37% (including dividends). Pring Turner Capital client portfolios were not immune to the damage, but our conservative investment philosophy and disciplined portfolio strategy did help to limit losses. Typical client portfolios are in position to recover to new portfolio highs shortly into the next bull market. Incredibly, in the last nine years stock market investors have endured two back-to-back serious bear markets (about 50% declines each). In the face of these declines, our clients' portfolio returns in the past nine years are still strongly positive.

The year began as we expected, with the economy slowing down and the average stock already down nearly 20% from 2007 peaks. A couple of temporary market rallies in the spring and summer gave us a false sense of hope the bear market might be over. However, in September, markets were abruptly shocked by a sudden worsening global credit crisis, leading to investor panic, and deepening our recession outlook. All major asset classes (stocks, bonds, real estate, and commodities) except US Treasuries collapsed leaving few places to hide. Years of reckless lending practices by financial institutions, especially related to real estate, came home to roost.

All recessions correct the economic excesses and mistakes of the previous business expansion. The chore of cleaning up messes made during the prior economic expansion is moving along quickly, but more needs to be done. While the process is painful, it is completely necessary to re-establish saner and more prudent business decisions that build the foundation for the next economic recovery. **Despite recent turmoil, 2009 and the next few years will be much more enjoyable and rewarding for investors, as the stock market begins to anticipate the next economic expansion.** In the rest of this newsletter we will explain how our business cycle analysis points to evidence for a brighter future.

LOOKING AHEAD — SEEDS OF RECOVERY

A massive effort by the government to shore up the financial system is progressing toward the goal of bank system stability. Governments around the world are making it clear they stand ready to supply as much capital as necessary to stabilize this ailing industry. While commonly called "bailouts" by politicians and the media, we view the government capital injections into banks as necessary "bridge loans" to enable the industry to nurse itself back to health over the next few years. The loans allow banks time to clean up their balance sheets, write off bad loans on the books, and over time, raise fresh capital from private sources to pay off the government loans. Taxpayer money is being put at risk, but with the government having a vested interest in banks'

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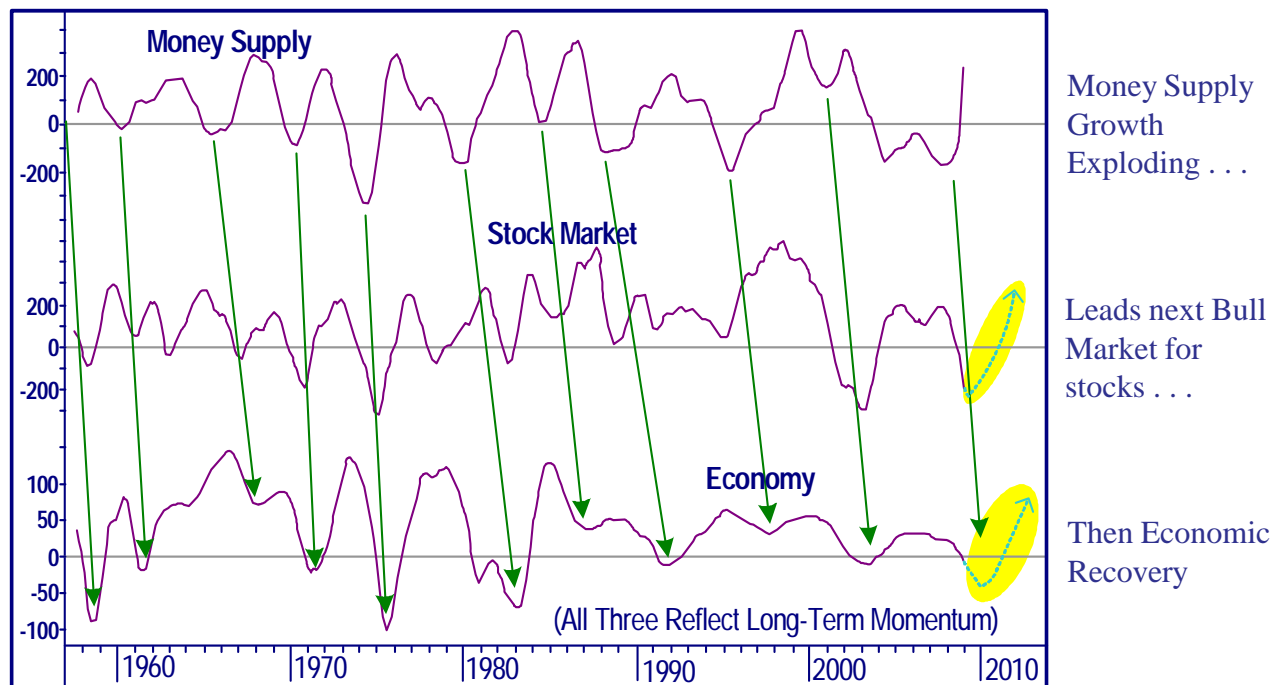
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ultimate success, there is also a distinct opportunity for the taxpayer to eventually make money on the loans. We believe the new administration is moving toward a strategy similar to the savings and loan rescue in the early 1990's. At that time, the government set up the Resolution Trust Corporation program that was successful in the *last financial system rescue*. The program allowed savings and loans and the economy time to recover from miscues of the prior expansion's ill-fated real estate boom.

Most importantly, to further bolster banks and the economy, the Federal Reserve has aggressively lowered interest rates and expanded the supply of money at a very rapid pace. Our studies of the last 150 years of business cycle history clearly show money supply creation is the engine of economic growth. Rapid increases typically lead to stock market recoveries and eventually economic expansions. At Pring Turner Capital Group we carefully monitor business cycle conditions to help us navigate through the inevitable economic ups and downs. This helps us look ahead and anticipate financial market and economic turning points. Pictured below is our informative chart tracking the growth in money supply and how it leads the stock market and then the economy. Glancing from left to right down the chart it is easy to see the sequential pattern that repeats over and over through each business cycle. Arrows on the chart point to ten previous business cycle sequences since the 1950's when money supply growth turns up strongly and, first, led the stock market and, second, economic recovery. As can be seen on the far right hand side of our chart, recent Federal Reserve efforts have led to a very rapid increase in money supply. **A strong stock market rally in the first half of the year will help confirm an economic reversal is imminent; a reversal we believe can begin by this summer or early fall.**

Money Supply Is Growing . . .



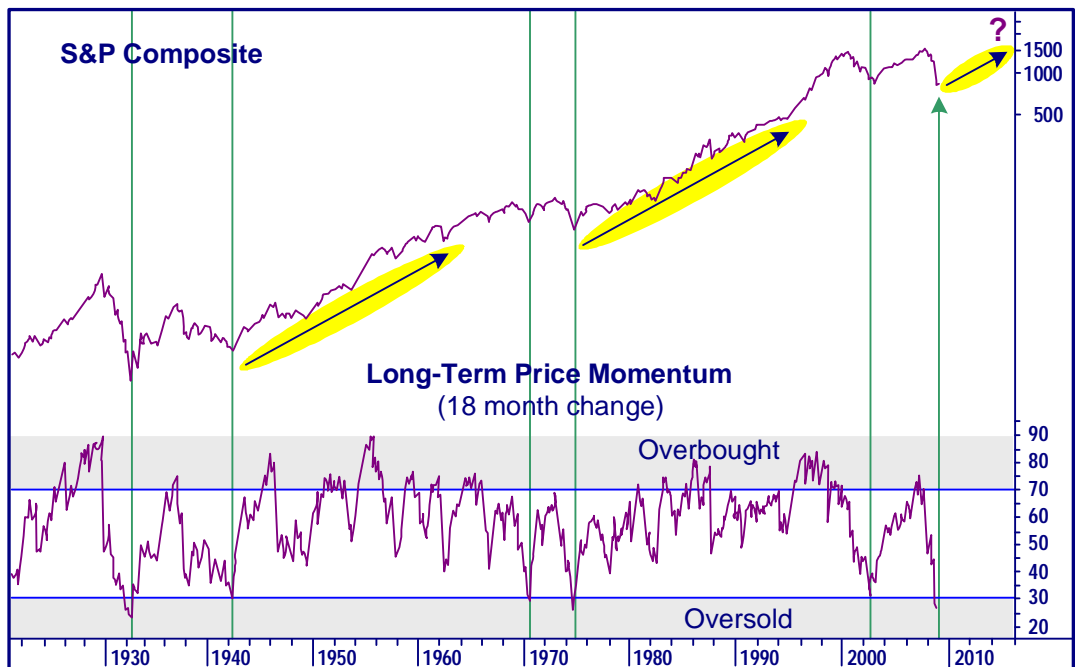
. . . And the Stock Market and Economy are Next to Grow

Clients have asked us the question, “Could this be a repeat of the 1930’s Great Depression?” In a word, NO! It is important to point out the rapid expansion in money supply growth is exactly the opposite of what the Federal Reserve did in 1929. At that time, the Fed had few forward looking tools to help gauge the economy and actually reduced the supply of money to the financial system, exacerbating the problem. The government made other policy mistakes including increasing taxes and raising import tariffs. All combined to help turn a recession into the Great Depression. Observers that compare today’s environment to that era are missing these key points. Also, a number of other stabilizing programs are in place today, including social security payments, pensions, and unemployment benefits to help cushion economic slowdowns. Combined, today’s multi-pronged efforts will avoid a 1930’s replay and lead to the next economic recovery. **We are confident the seeds of recovery have been planted and will likely lead to an end to the recession this year.**

Another analytical tool that we use to look ahead is the long-term momentum for the market itself. The chart below looks similar to the one we highlighted in our July 2008 newsletter showing oil prices. When oil was trading in the \$140’s and most oil “experts” were calling for \$200 oil, we warned the long-term price momentum for the commodity was at extreme and unsustainable levels. Oil’s recent spectacular fall into the \$30’s was deeper than even we expected, nevertheless it highlights the value of carefully watching long term momentum tools to spot changes of trend. We see a similar, yet opposite long-term turning point ahead for the stock market. Pictured below is the S&P 500 price history since the 1920’s along with a long-term momentum tool. As can be seen, this is only the sixth time in nearly 90 years when this long-term price momentum has fallen to this extreme a reading — twice in the 1930’s, twice in the 1970’s, and now twice in the 2000’s.

An important point can be made about the chart. Reversals from these second extreme oversold readings led to very large market rebounds in the years and even decades that followed. **Notwithstanding further short-term volatility and frustrations, we are setting up for a number of**

Second Step Stock Market Decline in 9 Years = Very Oversold Market



Pring Turner Capital Group

Sets Up Future Above-Average Stock Market Returns

above average profitable years for the stock market. It may take a bit more patience and time before the next bull market gets started, but once it begins, *and it will*, investors will smile once again.

A WALL OF WORRY

The stock market consistently leads the economy, often by six to nine months. In fact, the S&P 500 index is a key component of the Leading Economic Indicators, which tend to reliably forecast changes in the economy's direction. **The stock market will begin to advance long before evidence of improvement in business conditions show.** This is why the old wall street adage, "the stock market climbs a wall of worry", rings true. We all know there is plenty for investors to worry about today, but those who wait to feel more confident about economic improvement will find themselves and their portfolios left far behind. We expect the same result in this business cycle, as the stock market begins a long journey higher, even as the economic news continues bleak.

Our long-term optimism is only tempered by short-term concerns as the stock market continues to digest bad news and forms a major bottom. The healing process for the stock market has been underway for four months and may still take a while longer to complete. Looking ahead, you are in good position to take advantage of the next lengthy bull market. The second 50% stock market drop this decade has brought many great companies down to attractive yields and bargain levels. Value investors step in at bear market lows and accumulate stock and bond bargains that can be sold years later at much higher prices. As the stock market once again climbs a wall of worry, we are prepared to build your wealth to new all-time high levels. We look forward to the next wealth building phase. Thank you for your confidence.

SPECIAL ALERT: REQUIRED MINIMUM DISTRIBUTION RULE WAIVED FOR 2009

Please note that the rule for those taking Required Minimum Distributions for retirement accounts has been waived for the 2009 tax year (not for 2008). For clients who are age 70 ½ and older, you have the flexibility to not take a withdrawal from your retirement account this year, if you so desire. Please feel free to contact us to review your personal circumstances, and consider adjustments to your distributions.

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