

Perspectives

JANUARY 2009

THE YEAR IN REVIEW AND OUR EXPECTATION FOR 2009

2008 will long be remembered as a time of investor fear and turmoil on Wall Street. While no one can predict the future, we can certainly all agree that old paradigms are in question if not broken; brand-name banks have disappeared and the world is different and so are you. This new world will not abide by the old rules and conventional wisdom but rather by the new paradigms that are currently being shaped by major market forces: investor pessimism, Baby Boomer demographics, peak oil, trade deficits and exploding government debt.

In reaction to a weakening economy, a stock market which has seen its value cut in half in less than a year and over one hundred bank failures, the central bank of the United States otherwise known as the Federal Reserve has cut short term interest rates, the rate at which it lends money to large banks, from 5.25 percent to near zero percent. The actions taken by our government are unprecedented. You may be asking yourself what else is happening to help stimulate our economy and by extension the stock market? Here are a few...

- The Federal Reserve is now turned to more unconventional means of stimulating the economy and promoting lending because it cannot lower interest rates any further. These unconventional means include buying illiquid mortgage debt and other interest-bearing securities in exchange

for cash in an attempt to shore-up troubled financial institutions and encourage banks to begin lending money again.

- The cost to borrow money for a new or refinanced mortgage is at its lowest levels since 1971. The 30 year fixed rate mortgage fell to 5.14 percent as of the end of 2008. The lower the borrowing cost for a consumer often translates into more discretionary money to spend in the economy. Additionally, historically low mortgage rates can incent prospective homebuyers to make a home purchase thus help to stem the further decline in housing prices.
- The President-elect recognizing the need for immediate fiscal stimulus has purported plans to propose a package to spend as much as \$850 billion in 2009 and perhaps twice that figure over the first two years of his presidency for a FDR-like domestic infrastructure improvement initiative.
- The greatest economic stimulus of all comes from the decline in the price of oil. The price of oil declined by over 70 percent from its high in 2008. In many parts of the country the cost of a gallon of gasoline has declined from over \$5 to less than \$2. Each consumer now has recaptured thousands of dollars previously spent on gasoline which can be used to pay their mortgage and avert

foreclosure or spend it on discretionary non-durable items to stimulate the economy in some other manner.

Despite the promising signals of improvement previously mentioned, investors must be wary of the next financial disruption on the horizon: inflation. Inflation is the stealth tax on your future purchasing power and the value of investments due to exploding government debt. While few media news outlets mention inflation on account of the topic being overshadowed by the massive deflation of asset prices witnessed in 2008, we cannot permit ourselves to ignore our government printing press working overtime. The United States entered 2008 with almost \$11 trillion in debt and we proceeded to add another \$2 trillion in the final quarter of the year. There are stimulus packages and infrastructure spending initiatives which could add another \$2 or \$3 trillion to our national debt by the end of 2010. The government creates this debt by selling more Treasury Bills and Notes which act as a proxy for our currency. The greater the supply of our currency, the less each individual dollar is worth, thus the underpinnings of inflation put in place.

Consider for a moment that this debt is not someone else's national debt but a debt shared and owed by each and every American taxpayer. But taxes collected, which are the primary form of revenue to the US Treasury, amount to only \$1.6 trillion per year. With our national debt

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William J. Militello experienced Wall Street first hand as an institutional equity trader with Knight Capital Markets in New York, and currently serves as the Managing Principal of Piedmont, an SEC registered investment advisor. Mr. Militello has consulted for the Securities & Exchange Commission and is a graduate of the U.S. Naval Academy in Annapolis, MD, and received his MBA from Boston University. He is a Certified Investment Management Analyst (CIMA) and a member in good standing with the Investment Management Consultants Association (IMCA). Additionally, Mr. Militello is a volunteer with the Evelyn Brust Financial Research and Educational Foundation,

where he provides unbiased, professional investment advice on a pro bono basis.

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rising to an anticipated \$16 trillion by the end of 2010, we (aka: “the America Corporation”) will owe \$10 for every \$1 we make. Deficit spending begets more debt, while more debt accrues more interest owed and so on. Unless significant changes occur immediately and fiscal restraint is observed, the assumption of greater levels of national debt will likely usher in an era of US dollar devaluation and commodity and price inflation.

What specific steps has Piedmont taken to protect your portfolio? We added several new mutual funds to our line-up of choices which work particularly well during an inflationary economy. First, is the Treasury Inflation Protected Securities Bond Fund, it is indexed to the Consumer Price Index (CPI) which is commonly used as an inflation

index. Next, history has taught us that assets of intrinsic value such as commodities do well in inflationary times, so we added two more funds which track the price of a basket of commodities such as oil, gas, gold, silver, agricultural products, etc. When a currency is devalued as a result of an increased supply due to higher national debt levels, the price of a commodity typically goes up over time to counter the dollar’s loss of purchasing power. Therefore, a modest amount of these funds may be added to a portfolio and will likely serve as a hedge against inflation.

What can you do? Diversify your investments. Make sure you own a wide variety of mutual funds that represent at least three asset classes which have different risk and return characteristics. One of the best

ways to easily accomplish diversification is to use our managed portfolio service.

We expect 2009 to be a better year for the US markets in general; however, the investor should make plans to protect themselves from the inevitability of inflation by moving from long-term bonds to shorter-term bonds and adding mutual fund positions to their portfolio which comprise energy, precious metals and real estate that represent assets of intrinsic value and are commonly viewed as a store of wealth.

As always if you have any questions regarding your portfolio or the contents of this newsletter, please feel free to contact us. Thank you. – *William J. Militello, (703) 729-8333 EXT. 116.*

Featured below is a table of performance figures. The figures represent a comparison between the investment performance of Piedmont’s managed model portfolios versus well-known stock market indices (i.e.: the S&P 500 and the MSCI EAFE). I continue to conclude that managed portfolios that are broadly diversified, low-cost and follow the tenets of Modern Portfolio Theory perform better than an unmanaged index and discretionary accounts.

Periodic Performance Monthly: 10/2005 - 12/2008

| Data Series | 1 Month | 3 Months | 6 Months | 1 Year | 3 Years | 5 Years |
|---|---------|----------|----------|--------|---------|---------|
| Piedmont Ultra Conservative Portfolio | 1.75 | -3.18 | -4.58 | -2.76 | 3.45 | 4.14 |
| Piedmont Conservative II Portfolio | 2.50 | -8.90 | -11.40 | -12.30 | 0.34 | 3.10 |
| Piedmont Balanced Portfolio | 2.89 | -11.74 | -14.83 | -16.99 | -1.20 | 2.60 |
| Piedmont Growth & Income Portfolio | 3.34 | -14.55 | -18.15 | -21.48 | -2.81 | 2.06 |
| Piedmont Growth Portfolio | 4.14 | -20.05 | -24.41 | -29.88 | -6.06 | 0.83 |
| Index MSCI-EAFE (European Stock Market) | 6.02 | -19.90 | -36.32 | -43.06 | -6.92 | 2.10 |
| Index S&P 500 (U.S. Stock Market) | 1.06 | -21.94 | -28.48 | -37.00 | -8.36 | -2.19 |
| Index One-Month US Treasury Bills | 0.01 | 0.22 | 0.85 | 2.06 | 3.96 | 3.25 |

Performance Disclosures

1. The results portrayed are model results for the period 4/1/07 to present. Results prior to this date are hypothetical. There are limitations inherent in model results, particularly the fact that such results do not represent actual trading and that they may not reflect the impact that material economic and market factors might have had on the adviser’s decision-making if the adviser were actually managing clients’ money.
2. The results portrayed are net of investment advisory fees. A fee of 1.5% per annum was used to calculate the net of fees results. The fee schedule is in Part II Form ADV.
3. The results portrayed reflect the reinvestment of dividends and other earnings.
4. The models are compared to the S&P 500, One-Month US Treasury Bill Index and the MSCI EAFE (gross div.). The S&P 500 index is a non-managed selection of equity securities, which assumes reinvestment of dividends and has no trading costs, management fees or expenses, which would reduce the return. The S&P 500 is widely used as a benchmark and is widely recognized as representative of the broad general market for domestic equities. The MSCI EAFE Index is recognized as the pre-eminent benchmark in the U.S. to measure international equity performance. The One-Month Treasury Bill Index is a market value-weighted index of public obligations of the U.S. Treasury with maturities of one month.
5. For various reasons (tax, personal preference, restrictions, etc.) some clients of the adviser may have had investment results materially different from the results portrayed in the model.
6. The portfolio models are allocated among a group of mutual funds consisting of equity and fixed income funds depending on risk tolerance. The asset allocation for each model is available upon request.
7. The conditions, objectives or investment strategies of the model portfolio did not change materially during the time period portrayed.
8. Some of the mutual funds used in these model portfolios are currently not being recommended by the adviser.
9. It is not our intention to indicate that past performance is any indication of future results. As with any investment, returns will vary and there is a potential to lose money.