

Now that the inauguration is over...

Six years ago I sat in a conference room with an investment committee, as we were in the process of being hired. They had been working with a broker (masquerading as a consultant) and had enjoyed his brilliance until his growth strategy blew up (remember the last bear market?). Still saddled with some bad habits, they asked me what economic prognostications and writings I would be sending them, to keep them abreast of the market, so to speak. Only half in jest, I offered them a subscription to *The Economist*.

Running past my deadline, I spent the weekend reading *The Economist(s)* (as a fairly dense weekly they have a nasty habit of piling up in my inbox!) with an eye towards a theme for this letter; what can I say in a few hundred words to add real value to your thinking and assist you in this difficult moment?

My point is this: many far smarter and better informed than I have written volumes on the issues of import at the moment. Unfortunately, many foolish and uninformed, or corrupt and cynical (hard to tell one from the other sometimes) have spoken and written far more, and shouted it far louder. What are we supposed to think?

How did this financial crisis happen? What will happen next? When will we see positive outcomes? Are we headed for disaster? I hear the Great Depression invoked rather frequently these days, is that what we have to look forward to?

Funny, our new President ran as Abraham Lincoln but gave a Churchillian inaugural address. Not exactly toil and tears, but pretty darned close. That may portend a good direction, oddly enough. One seldom gets elected promising pain, but one must govern as a realist in times of crisis.

That being said, let's get over our simplistic focus on the Chief Executive and get back to where much of the power and continuity lie, Congress.

**From here
you can see
everything.**

How did we get here?

First of all, this represents a very simple summary of very complex issues. To be blunt, the most important thing is to know what we don't know, and to focus on learning and solving problems. Perhaps having a Democrat in the White House will enable us to "move on" to learning and problem solving and get beyond vitriol and "gotcha politics." Perhaps I am dreaming! LOL, as my daughter would say (i.e., text).

Bottom line is that emerging markets' (e.g., China) cash flows to the U.S. were overwhelming, as these newly profitable countries built massive reserves in the world's biggest, safest and most liquid financial system and currency. What did we do with these cash flows? Well, sadly, an awful lot of the cash bought newly minted AAA securities backed by bad mortgages, which put people into new houses they could not afford.

Congress got to pursue "noble goals" such as encouraging home ownership for the poor and the oppressed, so to speak. I am not being facetious; this was a primary explicit motivator and was phrased almost exactly this way. The fact that large amounts of money and political leverage were obtained in this way received less attention, and still does. Isn't it good to keep the focus on one man (Obama or Bush) so this kind of thing can be done in the shadows?

Much of the money financing the political efforts came from the Securities Industry. Or would you say Banking? Investment Banking? Retail Brokerage? Insurance? Is there any separation anymore? Anyway, lots of political money flowed to Washington, and the rest is history. The Big Financial Institutions got all the rules relaxed and ran with the new strategy until it blew up. And now here we are.

So what now?

Oddly enough, sometimes very bad things can cause good changes, changes that would be too painful to contemplate otherwise, or changes opposed by too many powerful politicians and other interested parties (e.g., the Securities Industry). Maybe we will have a direct and meaningful stimulus package and a return to sensible regulation (we used to know how).

Or we can put some lipstick on the pig. The best defense is a good offense - Congress attacks! Having created this crisis, how can they pass up the chance to attempt to pass the Mother of all Pigs past us, pork such as the planet has never seen or imagined? \$800,000,000,000? Not enough!

Not getting partisan here. All of that kind of thing aside, how can any elected representative resist grabbing some loot for his causes and his constituents? Democrats now in power have a backlog to work on, and the Republicans can sell their cooperation in exchange for their share – this looks a lot better as a bipartisan undertaking, after all.

Food for thought. What are your representatives working on?

OK, thanks for all the political hokum... I can hear that on Cable News! What do we make of the situation and what can we do?

I heard a NY/Washington talking head on one of the news shows Sunday, spouting strong opinions with equal parts ignorance and contempt for others, and I was reminded of the poor quality of most of what passes for thinking in the public arena these days. This person seemed oblivious to complexity and to her own limited knowledge, but that was apparently not a problem.

One of the worst things she said was, “It has not worked for eight years, something must be done!” Note both the political timeframe imposed on the issue, and the express willingness to proceed in ignorance, since “something” must be better than “nothing.” Sadly, there is a lot of this around, so let’s skip her name; she has plenty of company.

We need to remember our own limitations, and to heavily discount most of what passes for wisdom these days. Start there – we really don’t know what is coming. The markets have discounted a bad scenario, and beyond that, what is called “volatility,” which is a measure of how sharply markets move up and down over short periods of time, remains at record highs. The collective wisdom of the equity markets is aware of its own limitations, and thus the sharp reactions to every new piece of information or rumor.

The truth is, a bad global (let’s not forget the global nature of this) economy is in progress, is expected to get worse, and is already reflected in the markets. The credit markets are settling down. The deleveraging of personal and business

balance sheets is well underway, hopefully heading for a better and more stable place. The Banking System has been dramatically altered. The Regulatory Systems need major reform.

But what about me?

What we can do is carefully assess our needs and time horizon, and reexamine our strategy. We should not be investing money in risk assets which we cannot commit for a long time. Maybe we forgot about real risk, big risk, the Black Swan, and had too much invested in risk assets. Or maybe we are just feeling the pain and having a strong reaction. Who can blame us? This is very painful, and the future is uncertain.

Let's take a little time to reflect. Look down the road 10-20 years and think about our strategies. Let's not overreact, and let's not kid ourselves about being able to time this, or "get out until it settles down," or "find new ways to make money in a sideways market" – I always loved that one. New ways, hey! Call now!

We are investing in businesses, and we have some assets in fixed income to reduce risk. It is not magic, and there are no magic bullets. Our big decision is, for the long run, how much are we investing in businesses, large and small, all over the world, putting the assets at risk in seeking a substantial return on investment? And how much do we need to keep safe, in fixed income?

As always, we look forward to talking with you soon, and hope you are managing well through a time we will always remember.

Best Regards,



Roger C. Hewins III

President

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