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# FINANCIAL NEWSLETTER

## *A SIMPLE TRUTH: IT'S ALL RELATIVE*

*As investment managers, our aim is to reduce the drama and replace it with a tranquil level of boredom*

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The tragic year of 2008 turned out to be another of RS Crum's better years from a relative performance standpoint. Our average investor's portfolio declined less than 16%.

"Declined less than 16% you say! Are you kidding me? What kind of cockamamie statement is that? Relative you say? How say?"

We understand the reaction. Unquestionably, relative performance is one of the least understood concepts within the realm of investments. Relativity means that if you were to lose 16% of your money during a devastating decline, whereas most other investors were off by 40% or more, you should consider your performance grade an A. You achieved a great relative return!

Such was the case in 2008. There were devastating losses across the board for nearly every investor. Declines of 30% to 60% were commonplace.

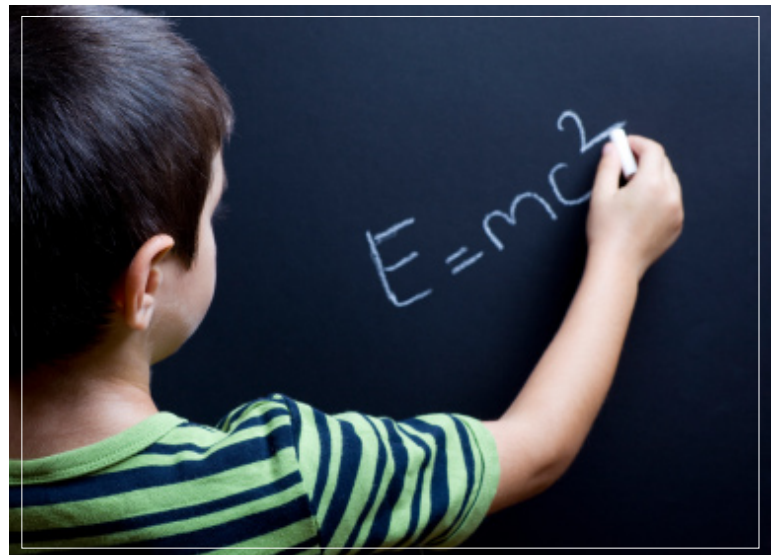
Even the most sophisticated managers overseeing some of the largest endowments in the world lost big time. CalPERS, Harvard Endowment, and the Stanford University Endowment Fund, just to name a few, suffered excruciating losses.

A bit closer to home, ask your neighbor or business associate how they fared. You may come to find that their investments lost half of their value or more last year as well. Full recovery is

a long, long way off for these folks.

But please, do not misunderstand; none of us like to lose, but losing some of the time is very much a part of investing. As illustrated by Dan Sexton in RS Crum's September *Financial Insights*, the importance of minimizing losses during market downturns is vital because it

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## AN IRONIC TRUTH: GORILLA IN THE MIDST

*The very people who helped create this mess are the same ones now trying to fix it*

Someone remarked that by the end of 2008, the seat of capitalism had finally relocated. It no longer resided in that soulless and mercenary financial district on lower Manhattan in New York City.

Its new home had become that foggy-bottom, politically conflicted area called Washington, DC. The greedy bankers were out and the power-broker politicians were in. We agree.

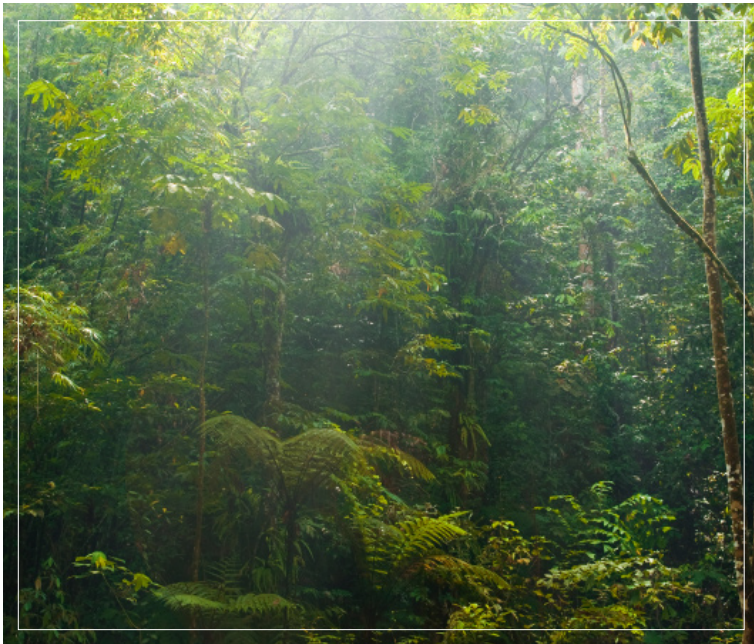
Metaphorically speaking, there is a new two ton gorilla that has stormed on to our financial marketplace, and soon we will all come to respect and recognize his

presence. His jungle, called capitalism, will inevitably find itself laden with a whole new set of rules and restrictions.

King Kong would be ashamed. Reduced to a monkey, his threat was a mere pittance by comparison.

Every time the new gorilla beats his chest, the roar of contrived stimulus will be heard throughout – from job creation to income czars; clean air mandates to energy initiatives; auto bailouts to healthcare reform – his presence will be known.

For better or worse, this gorilla's governance will be felt both here and abroad and new



winners and losers will evolve from it. The game of money will be changing and we, as investment advisors, better darn well pay attention.

Ironically, **the very people who helped create this mess are the same ones now trying to fix it**; which allows us to reflect on author Jimmy Breslin's book about his "Gang Who Couldn't Shoot Straight." In it, Breslin depicted his disreputable band of ne'er-do-wells as people *who could not run a gas station at*

*a profit even if they stole all their customers' cars.*

Gorillas to gangs, there might be a cogent analogy here. Our attitudes notwithstanding, however, we must pay heed. One must always be careful of any large unrestrained animal, especially when one finds themselves in the same cage.

## A GLOBAL TRUTH: BUBBLES HERE AND ABROAD

*We think we should continue to watch our backside a bit longer*

In the past few months there has been increasing speculation that the worst might finally be behind us; the stimulus is working; the economy is finally bottoming out. Even the Federal Reserve Chairman tells us there are “green shoots” appearing on our financial and economic landscape.

It is in light of these optimistic appraisals that our most frequently asked question is whether this financial nightmare is finally over? Are we actually bottoming out or is this positive market action merely a “head fake” with more loss and bad news to follow? More pointedly, should we, as your investment managers, begin to loosen the reins or should we maintain our defensive posture?

We needn't guess. Rest assured, *we believe your holdings are situated to gain a relative advantage either way.*

We have suffered no knock-out blows and we're within real striking distance of recovering all lost ground and attaining all time high profit levels on all client account holdings.

We are a bit less sanguine, however, as to whether this economic nightmare has ended. As such, **we think we should continue to watch our back side a bit longer.** There are numerous issues that may threaten this “green shoot” recovery, including a couple in particular.

### *Domestic Housing Prices: Round Two*

As we have said before, the price of housing has an immeasurable influence on domestic consumption and psychological well being. When the price of housing began its descent, the average American began to feel poorer and adjusted to it by spending less.

So went consumption, so went jobs. So went jobs, so went this economy. We have felt all along that the decline in the net worth of people's homes had become the “powder keg” for the turbulence we have witnessed.

Now, although there has been some evidence that we have seen a bottom to this housing misery, we are not completely convinced. There is yet another huge round of foreclosures scheduled to hit the market toward year end and this, combined with what is typically a slower selling season, could exact a further toll.

Although the worst may very well be behind us, if prices do indeed begin to decline once again, watch out below!

The American psyche is still quite fragile.

### *China Syndrome*

We are wary of a Chinese bubble-in-the-making. Their economic power has become a considerable factor on world markets today and any reversal in China could create some pretty adverse fallout elsewhere in our world.

They too were affected by this global slowdown and, to avert their own crisis, their government injected nearly a half a trillion

new dollars (currency equivalent) into the system. Based on the relative sizes of the U.S. versus Chinese economies, their stimulus package made ours pale in comparison.

However, unlike our domestic lenders, Chinese bankers took the bait and magnified their lending to essentially any borrower who could produce any product or service, real or imagined. “Keep the population working” has become China's mantra.

They are believed to have manufactured at least 25% more goods than they could ever consume or export. Rumor has it there are also huge unsold levels of merchandise that continue to pile up in every one of their available pier-side storage sheds.

Meanwhile, China's real estate prices are soaring as well; a frenzy that would shame any U.S. bubble watcher. The Shanghai stock market has taken its cue and advanced broadly, up nearly 100% in just the first few months of this year. This adrenaline type surge may end poorly. If so, the adverse consequences will not only affect world markets but will ultimately have an effect on our own pocketbooks.

The World's psyche is still quite fragile as well.



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## OUR TRUTH: ONE FOOT ON THE BRAKE

*If we are going to err, we would rather it be on the side of the conservative*

As financial managers, we know full well that there are some very complicated issues lurking which will require our utmost attention. So, with respect to your investment management, we intend for the time being to:

- Continue to manage money with *one foot on the brake* – our primary goal is still one of minimizing risk

- Continue with our search for safe sources of high income in our investments
- Continue with our diversification across each of the dozen or so of our distinct asset classes

We may come to find that we have been too cautious but **if we are going to err, we would**

**rather it be on the side of the conservative.**

Nonetheless, as was mentioned earlier, we *believe we are well positioned to gain a relative advantage* whichever direction these markets choose to take us.

### ▶ Continued from page 1: "A Simple Truth"

to recovery. Conversely, cautious investing during market rallies is often misunderstood or judged with a very short memory.

Of course you want to make money when markets allow; it is just that you want to do so judiciously. Going down by 50% then up by 50% still leaves your investments down 25% from where you started. Great drama, poor result.

Newer investors often request our perspective as to their future earnings potential. "Can I expect to earn 6% per year? How about 10%?" Although a very legitimate question, offering a specific answer without an explanation of relative performance would be inadequate. For example, if comparative markets earn 20% while you gain only 10%, that may be a decent absolute return, but it is actually weak in relative terms. Conversely, if your investments were to decline by 10% when everyone else lost 30%, this is exceptional.

**As investment managers, our aim is to reduce the drama and replace it with a tranquil level of boredom.** Thus, we will gladly accept our 2008 relative return, taking our A grade and pinning it directly on to your financial statement.