

## *Past Reflections*

**“Are markets forecasting a reversal of fortune?”** We posed this question a little over a year ago in September 2007 in our Special Letter we sent you. The following are excerpts from that same letter:

*You [our clients] have all been richly rewarded these past five years. Your respective fortunes have grown meaningfully.*

*[However] we are now feeling a new and heightened sense of concern.*

*[Financial] terms such as sub-prime lending, foreclosures, credit constriction, excess leverage and weakening real estate prices are making their way into our financial lexicon.*

*. . . the slowing real estate market would cause greater economic damage and distortion than economists [were then forecasting].*

*. . . this sub-prime mortgage mess has always been a catastrophe waiting to happen.*

*. . . we disagreed with the consensus that argued that (this) would only be a small and isolated problem. To the contrary, we felt that it was the mere tip of the iceberg and it would ultimately become a risk-virus that would leak out and infect other aspects of the credit market on a world wide basis.*

*The real problem is excess leverage, excess borrowing, excess debt.*

*Credit reduction or credit constriction is today and always has been the precursor to wealth reduction.*

*(Continued)*

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*“The real problem is excess leverage, excess borrowing, excess debt.”*

*“We were expecting a difficult period. As you now know it was far worse.”*

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## *A SPECIAL LETTER FROM RS CRUM February 2009*



## *Past Reflections* (Continued)

*We have taken a series of steps to reduce the risk in your investment holdings.*

Although now, nearly a year and a half later, this historical narrative might be intellectually gratifying for us, it does not reflect the magnitude of the financial earthquake we actually endured. We were expecting a difficult period. As you now know, it was far worse. From an investment standpoint there were few places to hide.

## *RS Crum's 2008 Report Card*

We have been saddened to witness the typical investor, many of them friends and neighbors, suffer the loss of sometimes fifty percent of their money, sometimes more, this past year. This is truly staggering!

During 2008, the RS Crum client composite holdings only declined by about **15%**!

Although we sure weren't perfect, we did wind up with a pretty high relative score. Once again we wound up well ahead of virtually every one of our peers.

As we have said so many times in the past, the key to successful long-term investing is never measured from the perspective of how much one might make, but always

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*“Or as Carville might have said,  
It's the Debt, Stupid!”*

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in terms of how much one does not lose. **He who loses least wins.**

But, how does one begin to understand the overall economic problem? Why is this happening?

## *It's The Debt, Stupid!*

As campaign adviser James Carville once told Bill Clinton's re-election team, "Remember, it's the Economy, Stupid!"

Now, today, amidst all the nightly rhetoric that wafts through our air-waves, we need to point to the fact that our financial system has simply allowed too much debt to be issued to too many who can no longer afford it, and, ultimately, will never be able to repay it. Or as Carville might have said, It's the Debt, Stupid!

In the search for answers one should avoid pinpointing any single culprit. Our over-burdened and over-borrowed state of affairs is not solely attributable to greedy financiers, unscrupulous loan brokers, or even selfish investment bankers; **it also took the permission of John Q. Public.**

Whoever said it was okay to owe 110% on one's home, to have three credit cards maxed out, and to lease two high priced cars? Who said it was okay to become over-spent and under-saved?

Then, when the housing bubble finally popped, all of that debt remained. Next, when John Q's job disappeared, his ugly debt service became even more unmanageable. Suddenly, John found his lifestyle was no longer affordable and he began the search for escape. Foreclosure and/or personal bankruptcy were his only viable options.

But, alas, these actions do not dismiss this debt. They merely transfer it back to the original lender. You see, bankruptcy and foreclosure only act to rearrange the seating arrangement in the musical chairs of financial layering. The debt still exists, but now someone else is responsible for it.

Predictably, then, the equity of these original lenders is the next to evaporate as they too find themselves in an unaffordable, illiquid and untenable state. They, too, begin their search for viable bailouts or alternatives of escape (to wit: The collapse/bailout of Freddie Mac, Fannie Mae, Wachovia, Washington Mutual, AIG, Bear Stearns, Merrill Lynch, Countrywide Mortgage, et al. The list goes on and on).

Soon this debt-virus infects other assets and other losers appear. During 2008, for example, the price of virtually every asset began to weaken. Behold, we witnessed a world-wide decline in the value of real estate holdings, stock market investment, commodities and bonds, **all of which were occurring at the very same time.** We have never seen such a complete chain of losses in all areas of equity so simultaneously and so comprehensively. Yet, the debt remains.

As your advisor, we do not want to be blinded by a lot of white noise in this mess. Debt forgiveness and loss will become the Achilles Heel for investors in this next cycle and **the real question is just who is going to wind up holding all of that suddenly worthless debt when this noise stops and this game is finally over?** Just who will wind up owning all of that worthless credit card debt? Who will possess all of those junk bonds that have defaulted their way into oblivion? Who will wind up with the excess mortgage debt?

We understand. The answer is deceptively simple: "It's the debt, stupid!" When the music finally stops we at R.S. Crum intend to have our investors seated well ahead of everyone else.

## *Our Investment Survival Kit*

For those who have been with us any number of years, you know that we have always maintained a strong level of comfort from the tools we nurture in our investment kit.

### **Tool #1: Stay Close**

During bad market periods our primary goal is to stay close.

Do not reach for extra yield. The real question today is not in how much you might earn, it is how much you do not lose.

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## *Our Investment Survival Kit*

*Tool #1: Stay Close*

*Tool #2: Stay in Balance*

*Tool #3: Stay Flexible*

*Tool #4: Stay Within*

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## *Our Investment Survival Kit (Continued)*

### **Tool #2: Stay in Balance**

Given our September 2007 prognosis our most commonly asked question is: "So if you felt so strongly about what was to unfold, why didn't you sell everything and go 100% into the safest haven?"

Indeed, this is a worthy question. We must preface the topic by sharing with you that our personal money is invested the same as yours. We, too, do not like to lose money. However, we have also endured many bear-type markets over the years and have come to discover that we are all better served by maintaining a balanced investment holding with some risk mixed with a lot of safety.

Although this approach does not allow for perfection, it does minimize the guesswork and future timing. It is one thing to be right in concept and quite another to be exact in both timing and duration as well. When one embarks on the guessing and timing game an investor needs to be correct in all three areas not once, but twice, to gain a financial advantage. The odds of this are not in one's favor.

We know that by staying close and staying in balance, eventually markets will swing back in our favor.

### **Tool #3: Stay Flexible**

We are constantly searching for new investments that make sense and creative ways to further reduce risk.

However, whenever we do implement new investment approaches, we always do so in a very measured and modest

manner. We do not choose to have any large percentage of your holdings in any single risk type security.

### **Tool #4: Stay Within**

We never transfer investment decision-making or control to any outside adviser. We, and we alone, make all of your investment decisions and selections, for better or for worse.

## *So, Where Next?*

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*"This too shall pass"  
... Anonymous*

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All cycles end whether they are positive or negative in nature. In time both sanity and clarity eventually return to the marketplace. Eventually, we will be given the opportunity to recover. In the meantime our primary immediate goal is to stay close. Panic is our enemy. Protective patience is our ally.

We will continue to exercise vigilance and restraint with respect to your investments. In the meantime, thank you for your continuing patience. We are quite aware of how difficult and trying this has been for you. There will be better and more profitable days ahead.

Yours very truly,

**RS Crum Inc.**

