ELLIOTT ASSET MANAGEMENT

San Diego, CA

Voice: 866-USA-7373
Fax: 206-222-2772

EAM Newsletter for March 9, 2009

Record Lows May Spell Opportunity for Superior Long-Term Returns
- Once again we are becoming more aggressive (like we did in late October of last year)

Once again we are scraping 12 year lows. The large cap (blue chip) indexes are all down more than 50% in the last 18 months, foreign and smaller stocks are down even more. This is the worst bear market the country has endured in over 70 years.

The pessimism is palpable, which is generally a good sign for investing in stocks. I continue to believe the rationale for pessimism is well-placed (as we have been discussing all along) but, similar to late October, I am once again seeing many exceptional opportunities in the market *despite* my belief that the economy will fare even worse than most pessimists are predicting.

In light of these opportunities we cannot change course and react to a market that has decimated almost any effort to achieve a positive return. We must stay rational and *not react*: that is generally what amateur investors do and it kills returns. When the typical stock in the Dow Jones is off by more than 50% then there is almost certainly opportunity to make a good return over the longer term. And that is where we must continue to place our focus: on those events just over the horizon that lay beyond our view. And there have been many times in the past when we felt the world or our country was going into a perpetual tailspin. Each of those times were followed by tremendous bull rallies. This may or may not be the case *this* time:. But universal adoption of the idea that *this time may be different* has almost always been a harbinger of change. And sudden appearance of clear proof *that time wasn't different!* (Many of you made that argument to me about the housing market not long ago!)

There is a lot I would like to discuss and, as has become commonplace, events change fast enough to warrant revisions before I can publish anything. Therefore I have decided to provide an outline of the issues I would like to address and expand on a couple of them at this point. If you have any questions on the other issues feel free to call me, otherwise I will try to address them in future newsletters.

Here is the outline of the agenda

- Top Portfolio Holdings
    - #1. Diversified Common and Preferred Stocks: The market is at 12 year lows and I believe there are potentially fantastic *long-term* bargains out there. Remember the age-old adage to buy low and sell high? T*o buy low we must buy when others are scared (and sell when others are optimistic).*

ELLIOTT ASSET MANAGEMENT

San Diego, CA

Voice: 866-USA-7373

Fax: 206-222-2772

- #2 FDIC Insured CDs: These are among the safest of investments and are not new positions. We are still holding several CDs we purchased 2 years ago that yield in excess of 5%. When these CDs mature we will likely invest the proceeds elsewhere.
- #3 A Convertible Preferred Stock: Our only recent new addition to our top holdings is a convertible preferred stock. I believe this investment presents an exceptionally compelling long-term risk/reward opportunity, but is thinly traded. I have withheld the name because we are still accumulating shares and this stock is extremely thinly traded. Our trades have at times made up more than 25% of the entire daily trade volume and EAM clients now own almost 0.5% of one class of the outstanding preferred shares of this particular company. I will write more about this company after I have finished accumulating shares in all client accounts or until the share price exceeds a level I am willing to continue share purchases. More to come!
- Municipal Bonds: Tax-free bonds we mostly bought on fire sale last fall. Two California issues appear in our top 10 holdings, which is reflective of our large client base in California. The other municipal bond that appears in our top 10 holdings is Guam International Airport bonds. US territory and district bonds (Guam, Virgin Islands, Puerto Rico, Washington D.C.) are tax-free *anywhere* in the country. Investment grade municipal bonds are often considered the second safest investment, just behind U.S. Treasury bonds, yet the average tax-equivalent yield we are receiving is in excess of 11% (for clients in high tax brackets)! These bonds should be even more valuable when taxes are eventually raised.
- Investment Grade Corporate Bonds: We purchased a lot of corporate bonds with ratings of “A” to “AAA” last fall and picked up a few more issues so far this year. Our average maturity is over 15 years and the average yield to maturity is over 10%! These bonds should form a good anchor for many retirement plans.
- JNJ and PG: Johnson and Johnson and Proctor and Gamble. These two positions, are the only individual stocks that appear in our top 10 list of holdings. These are two of the best run, stable, and recession resistant companies in the world and are appropriate for almost any of our investment accounts.
- TIPS: US Government Treasury Bonds that are indexed to inflation. Even though we expect deflation in the near term, the risk of inflation longer-term is substantial due to the ballooning deficits, increased public spending, and the liquidity that is being pumped into the economy by he Federal Reserve.

- Strategy – once again, there is no "safe" place to run. We must continue to find the best risk adjusted returns no matter how horrible the markets have been (and generally down markets generally provide the best long-term opportunities)
    - Cash is not safe, Long-Term US Treasury Bonds are not safe (near-term), gold is *not* safe (although fear could propel prices significantly higher in the near term)
    - My job is to do what I believe is *best* for you – and not just try to avoid being fired (how most advisors run portfolios, perhaps why most advisors and fund managers under perform). I will strive to never substitute panic or euphoria for logic. Therefore I will continue to stand alone in many decisions. I believe, in this regard, we have been more right than wrong (most recently our negative assessment of the real estate market), but there is no assurance we will be right on any of our contrarian investments. I believe our current investments should very beneficial to our clients over the long haul.
        - As you check your gut or start to panic try to recall how our *feelings* were for markets of the past:
            - Think back to October 2007 when the market was hot and you may have been excited to put more money into the market. What a bad decision that would have been (and I stopped many of you from doing it!).
            - Last year everyone thought oil would hit $200-$300 per barrel and commodities would continue to skyrocket. Oil is now down almost 70% from the highs! *We said prices appeared overhyped.*
            - Last January gold broke $1000 per ounce as amateurs loaded up, only to crater (before recently coming back). *We avoided buying gold when many of you askd us to when it broke $1000 per ounce*
            - 18 months ago emerging markets were fated to continue to drive raws materials demand higher and increase global growth in perpetuity. The average emerging market fund is down over 70%. *We got hurt with some emerging markets bets!*
            - Two years ago the real estate market was cresting new highs and many were refinancing their properties to buy more to cash in on the "sure thing" of continuous real estate appreciation. Now real estate is crashing, even after prices have substantially fallen. *We vocally and passionately urged clients to sell real estate from 2004 through today.*

ELLIOTT ASSET MANAGEMENT

San Diego, CA

Voice: 866-USA-7373
Fax: 206-222-2772

      - In 2002 most felt the stock market was for suckers. *We were aggressively investing at that time.*
      - In 1999 everyone believed tech stocks would make most investors rich. *I urged anyone who would listen to dump tech stocks and buy real estate!*
      - Now everyone is running for the hills as stocks plum new lows. Is it the right action to take? It depends, but history has demonstrated that our *feelings* are usually *wrong*. Many stocks looks extremely cheap to me at these 12 year lows. I am suggesting most investors be more aggressive at this conjecture.
    - In sum: our comfort and instincts are not any better \ helping us choose when *not* to put money in the market than they are with putting money in. Generally we should do the opposite of what our gut tells us!
- I am starting to see and hear the first *real* panic I have seen, which is generally a *good* thing for the markets!
  - The American Association of Individual Investors recently reported that *pessimism is at a record high* from when they started keeping records over 20 years ago. Generally widespread pessimism precedes large bull rallies. Think back to 1982 when almost everyone predicted the end of Western Civilization – and that was followed by one of the largest and longest bull markets in history.
  - Buy low and sell high - not buy high and sell low!
  - Thus, even though I think things are even *more* dire than what is current general consensus is (and I know consensus is quite negative), I believe there are still fabulous opportunities for long-term investing in the current market. Especially when one considers there are few reasonable alternatives (per my rationale) for our investment dollars
- Last year's very high number of trades were very unusual, but it was a very unusual market
  - Large swings in market valuations presented many opportunities trading shares for ones with better perceived risk/reward ratios. In taxable accounts we were more likely to make trades to realize losses that can be carried back on your taxes 3 years or forward indefinitely.
    - Be sure to ask your tax preparer to see if it makes sense to amend previous years taxes to get a bigger refund (again only for clients with taxable cash and margin accounts)
- Overall market indexes performance peak to trough (most hit new lows on Friday)

ELLIOTT ASSET MANAGEMENT

San Diego, CA

Voice: 866-USA-7373
Fax: 206-222-2772

- **Last year was the worst year in the markets since the 1930's**, this year is not looking much better
- **The Dow Jones Industrial Average is down** ***54.9%*** in the past 18 months. The largest and most stable companies in the world make up the Dow. Therefore other more typical stocks and international stocks are likely to be down *much more, especially in aggressive portfolios.*
- **S&P 500 DOWN 57.7%**
- Russell 2000 (smaller companies) down **60%**
- Vanguard European Index down **63%***
- Powershares Asia Pacific down **71%***
- None of these results account for transaction fees, management fees, or taxes (domestic and foreign).

- Other noteworthy observations
  - I believe the current malaise will usher in days of much larger government in the USA (almost a given now) and it will also finally start movement toward true reform of Social Security, Medicare, and the health care system. I believe we will have a socialized health care program within the next decade – and that will mean momentous changes for my numerous clients in the medical profession. *Prepare now.*
  - Many of the changes and job losses in the economy are likely structural, not temporary. I believe high unemployment shall last longer than most expect. Unlike other recessions, these jobs that were lost *are not coming back.* Many people will need to be retrained for other jobs.
  - Chance of competitive currency devaluation (governments printing money backed by nothing, one of the reasons cash is not safe). In a future newsletter I hope to revisit the gold article we published last year – and why gold may look good for the near term as more people panic, but is likely to be a laggard over the longer-term.
- **It is time to contribute to IRAs.** Hard as it may be, we need to buy low and sell high which means we need to fund our accounts when the market is in the dumps (1982, 2002, and now), and not just when we are feeling manic (like 1999 and 2007). This is a much better time to be investing than last month, last year, and especially 18 months ago!

Also please note with tax season and with the markets hitting new lows that my time is at a premium: I may have little time to write much for some time (I have to speak with all of you, do my taxes, and research investment opportunities). I am also scheduled for reconstructive shoulder surgery next week on my dominant shoulder (old sports injury). This will also make it near impossible to write much for several weeks. Please understand that I shall be working hard for you, even though I shall be writing very little!

ELLIOTT ASSET MANAGEMENT

San Diego, CA

Voice: 866-USA-7373

Fax: 206-222-2772

As always, feel free to call me if you have any questions or if you wish to discuss any of the topics mentioned in this outline in more detail. Meanwhile, try to keep optimistic while preparing for worse times ahead. Continue to save money and invest. I believe you are likely to be very happy with the results over the long-run!

Best Regards,

Mark Elliott, President

Elliott Asset Management

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS. THE INVESTMENTS DISCUSSED HEREIN CAN LOSE SOME OR ALL OF THEIR VALUE.

This document is intended for purposes of discussion only. None of our publications (including this one) is meant as investment, legal, tax, or any other advice of any manner. Consult with your Investment Advisor, Attorney, Accountant, or other appropriate professional before acting on anything contained in this document.

Elliott Asset Management (Mark Daniel Elliott) is a Registered Investment Advisor under the jurisdiction of the California Department of Corporations and the NASD (CRD#139796). We can legally accept clients from anywhere in the USA. Registering with the California Department of Corporations or the NASD is not and should not be interpreted or construed as endorsement of our company or service.

*These figures may slightly overestimate losses for the Vanguard and Powershares funds due to dividends, however assuming dividends were reinvested the actual results should not vary by more than 1-2% (estimated).