TRIAD
INVESTMENT MANAGEMENT

4th Quarter 2008 Client Letter

"The nine most terrifying words in the English language are, 'I'm from the government and I'm here to help"

- Ronald Reagan, 40th President of U.S. (1911-2004)

In what was one of the most tumultuous years in decades, the U.S. economy entered 2008 in recession (the official start date is December 2007) and the stock market suffered the worst decline since the 1930's. The current recession is anticipated to be the longest and deepest since the early 1980's. Stock market averages were down roughly 35-50%, and most areas of the market were hard hit. Wall Street and investment banking have been permanently altered, oil prices rose and crashed, housing continued to decline, millions of workers lost jobs, Bernard Madoff admitted a $50 billion Ponzi scheme, while hedge funds, private equity and other leveraged investors discovered the downside of using borrowed money to invest.

It was quite a year. Quite a year to forget. While we were not immune to these negative events, my focus continues to be on things we have control over: the types of investments (stocks and bonds) we own, and the prices at which we buy and sell. Ultimately, the economy and stock market will recover, and while I can't predict when, my job is to position your investments to benefit from an eventual improvement in conditions.

Various government programs are being mobilized to deal with the current economic and financial situation. The U.S. banking system is chock full of questionable assets, purchased when times were good and money flowed freely. Now, credit markets remain strained, loans are difficult to obtain, and financial companies continue to need capital to repair balance sheets. The financial crisis has intensified the weak economic conditions, and over 3 million workers have lost jobs in the past 12 months or so. This is not just a United States problem. It's global and it is creating problems everywhere.

Given the magnitude of the situation, the U.S. Government along with foreign governments, have stepped up their assistance in two primary ways. The first has been the U.S. Federal Reserve and other central banks worldwide stepping in as a lender of last resort, extending credit on assets such as residential and commercial mortgages, corporate loans, asset-backed securities and collateralized debt obligations. Many of these assets were "packaged' into pools by creative Wall Street bankers, hungry for fees, who fed an income-starved public during a period of relatively low interest rates. The second role of government is just getting ramped up, and that is spending more money to stimulate the economy. Congress recently passed legislation to spend around $800 billion over the next few years on a variety of measures to breathe some life into our economy. China is spending $600 billion to do the same. And Europe will be doing the same. Basically, the governments of the world are attempting to jumpstart the global economy through massive monetary easing (lower interest rates and easier borrowing terms) and fiscal stimulus (some might call it pork-barrel spending). If history is any guide, the combination will have its desired effect of eventually lifting the economies out of the current severe downturn. If history is also any guide, the cost of this might prove to be higher inflation in the future, and a weaker currency.
In short, no free lunch. Not even from Uncle Sam. I'll be monitoring the various actions for their impact on the medium-term and long-term outlook.

Some investors have voted with their feet, selling assets and now sitting on the sidelines. While this provides immediate pain relief, meeting long-term financial goals will usually require something other than burying your money in the backyard, or putting it under the mattress. Short-term Treasury securities now yield 0-2% (not a typo), which after taxes and inflation is equivalent to the mattress.

I am often asked whether if it would be better to reduce stock market investments until the economy recovers and the financial markets stabilize. Investing is about making decisions about the future without complete knowledge of how that future will unfold; when the crystal ball is particularly cloudy, as it now appears, investors don't attempt to gaze very far. Stock market valuations seem to reflect greater fuzziness. Many stocks appear to be ridiculously cheap, and while many investors would acknowledge this, many are not willing to make decisions in a highly uncertain environment.

So, while the past year has been painful for investors, current stock market valuations have created the potential for good returns over a 2 to 3 year timeframe. And the alternatives don't look sufficiently attractive in my view to warrant significant commitments. U.S. government bonds are yielding between 0% and 3% currently, residential real estate continues to decline, and commercial real estate is just getting started on a down cycle. One exception is corporate bonds with relatively attractive yields, and I continue to evaluate their risk and return prospects as alternatives to equity investments.

A few general comments about your stock investments: we have a diversified portfolio with no single investment representing a large allocation of assets. We do own economically-sensitive companies that perform relatively better in periods of economic growth. Examples are energy, manufacturing and some consumer businesses. Investors have sold these companies fearing a weak economy will reduce earnings. As a result, current valuations seem very attractive, and while these companies will likely see relatively weak earnings during a recession, as we approach the end of the recession, possibly in late 2009, investors should start to gravitate back toward these businesses. We are assuming and are invested for a return of growth to the economy.

I seek to invest in businesses that have the ability to weather the current environment, take advantage of the downturn to strengthen their positions, and potentially emerge in a stronger competitive position. I look for three primary elements when evaluating potential stock investments:

1. Competitively-entrenched businesses with good profitability operating in growing markets;

2. Management that owns stock and has a track record of shareholder-oriented decisions;

3. Attractive valuation to provide adequate returns given the potential business risks.

Trade-offs inevitably arise and my job is to balance the relative attractiveness of each element when making a purchase decision. For example, investing in a management team with a history of good decisions operating a business that is slightly less profitable, but available at a very compelling valuation.

Energy companies continue to look attractive for long-term investment. Although the price of oil has declined from $145 per barrel last Summer to around $35-$40 today, it is my opinion that steady growth in demand, particularly from emerging economies, and a struggle to generate enough supply will continue to put upward pressure on oil and natural gas prices. Perhaps not $145 per barrel soon, but the reality is the easy reserves have been found and consumed, and new finds are generally smaller, difficult to extract (remote locations and deeper in the ground) and therefore more costly to produce. Combine this with the developing world's continuing desire to live like us, with cars, homes to heat, electricity, etc. and you have a recipe for long-term investment gains. However, in the short-term, the weak economy is reducing the demand for most forms of energy; once the economy strengthens, look for higher prices at your local gas pump.

One final word about the long-term. The sobering reality is that while U.S. stock markets have delivered around 10% per year over many decades, it has been estimated that the average investor has earned only about half that amount due to poor timing decisions as they reduce their stock investments during market declines and increase their holdings after markets have appreciated substantially.

While the investment business is never easy, it is made easier for me by having clients who retain a long-term orientation. I truly value my relationships and appreciate the trust clients have demonstrated over the years. It is my aim every day to see that your trust and patience is rewarded.

Sincerely,

John Heldman, CFA