



Advisors Access Newsletter for April 2008

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The volatility continues. As we all face the daily ups and downs of the current stock market, it may seem hard to remember the go-go days of the late 1990s. The buzz at that time was that we were dealing with “a new economy”; supposedly, the tried and true principles we all learned in tenth-grade economics were no longer applicable. Corporate profitability (or lack thereof) was irrelevant, the stock market would continue growing ad infinitum, and returns seemed to have become completely detached from risk.

Then the bubble burst, and the harsh realities of tenth-grade economics suddenly slapped Wall Street (and much of Main Street) squarely in the face. Profits do matter. The economy truly is cyclical. And you can’t obtain super-sized returns without taking super-sized risk.

How quickly Wall Street forgets. Fast forward a few years: Need a \$500k mortgage but can’t prove you have the wherewithal to repay the debt? No problem. You want an investment that offers the safety of cash but pays a higher return than a standard money market? No problem.

Of course now in hindsight, Wall Street and the media see the absurdity of everything that led to the sub-prime mortgage crisis, the resulting credit crunch, and, most recently, the problems with auction-rate securities (whereby investors were sold “cash-equivalents” with a higher yield, but now cannot even get access to their money).

Despite the admonitions of early-20th century poet and philosopher George Santayana that “Those who cannot remember the past are condemned to repeat it”, Wall Street has recently been forced to re-learn some of the most basic economic principles. Even some of the talking-heads on CNBC have made that admission.

At Capital Directions, we routinely field questions from clients about “new” investment trends such as hedge funds, private equity, and the like. While we are not so stubborn as to miss a true advancement such as the Inflation-Linked Bonds of the PIMCO Real Return Bond Fund used in *Advisors Access*, we are very wary of any investment that promises to stretch the risk-reward equilibrium.

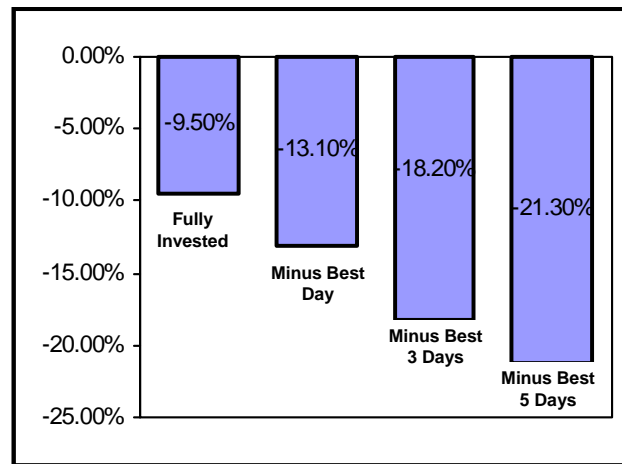
The basic economic principles we were all taught in school do not change, and you can count on Capital Directions to remember that as we manage your retirement assets. We will seek to maximize your risk-adjusted return, but we will not take the types of risk that created the sub-prime crisis or the problems with auction-rate securities.

An Update on the “Out of the Market” Effect

A number of folks found our January piece on the impact of missing just a few good days to be very impactful, so I want to provide an update. While the first quarter was a difficult one for stocks worldwide, those who tried to time the market faced an even more difficult challenge, as shown below.

Impact of Missing a Few Key Days of Gains in First Quarter 2008

S&P 500 Index: January 1 – March 31, 2008



Advocates of market timing love to argue that it is better to miss the worst days in the downturn even if you miss the best days along with it. Interestingly, however, when we removed the three worst days from this quarter’s performance along with the three best days the investor would have achieved a return of -10.60%, which was worse than the S&P 500’s fully invested return of -9.50%.

There is also a fundamental flaw in the logic that it is better to miss the worst days even if you miss some of the best days, too. To miss the worst days, you somehow have to identify them in advance, move out of the market and then correctly decide when to get back in. In contrast, the stay-invested approach assures that the investor will be in the market for the recovery because he or she never left in the first place.

We can’t tell you when the recovery will begin, but we can assure you that economic principles do not change: The markets will recover, and our investment philosophy at Capital Directions is dedicated to helping you be a part of that recovery.