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Fear subsides, market rallies, anxiety continues, a normal day at the office.

Client Newsletter
Quarter Ending September 30, 2009

Last quarter saw a continuation of the market rise that began March 9, 2009. The rapid increase was largely the result of a lifting of the fear factor that pervaded the markets after Lehman Brothers failed last fall. As fear of another Depression gripped the markets, the Federal Reserve, and Central Banks worldwide struggled to keep the economy from falling into a calamitous world wide Depression. As central banks realized the gravity of the situation, they took drastic steps. They stared into their own graves. Secretary Paulson pronounced these times as "...an economic 9/11." The "entire economy was on the verge of collapse", he said. It was believed that if Morgan Stanley was allowed to fail, Goldman Sachs would follow in six hours, big banks would follow, and no one knew what would happen after that. (Excerpts from, *Too Big to Fail*, Andrew Sorkin, Penguin 2009)

With fear and panic in the air the Federal Reserve backstopped the financial system with a variety of tools, some old and some invented for the occasion. Interest rates were pushed to near zero, and the money supply greatly expanded. New credit facilities were invented and the Fed guaranteed money market funds as well as credits of various kinds. Left to fend for themselves were small business as big business such as GM and Chrysler were advanced Billions by the government, and failed anyway. Consumers were thrown overboard by banks and credit card companies. Even to this day getting a bank loan or mortgage is exceedingly difficult even though financial institutions have been given billions in essentially free money by U.S. taxpayers.

Because of these massive efforts by Central banks, gradually we pulled back from the edge of disaster, and investors began again to believe in the economy. The market gains were not justified by the economy or earnings, but they did represent the subsidence of the extreme fear. As fear left the markets, they began to return to normal and business began to function more or less normally.

Companies engaged in cost cutting. Massive layoffs ensued. The unemployment rate is approaching 10% and climbing. Even with falling revenues, companies began to show improvement in earnings, even if the improvements meant only smaller losses because of the cost cutting. The market was heartened. But, companies cannot cut their way to prosperity. They need revenues. So, the market increase has been the subject of debate as to its merits, for without revenue growth, profit growth (or smaller losses) cannot continue. It is hard to see how

we get revenue growth without spending, and with unemployment increasing, banks cutting off credit, and businesses cutting, where does the revenue come from? Sooner or later revenues will need to grow. The jury is still out on this market rally.

While we have participated in the rally, we have been cautious as well, as we have kept a foot in both camps: 1) the rally is for real; 2) the rally is overdone. The result is that many of our holdings have been cautious, and we have not participated completely in the rally. This will be a wise strategy if the market pulls back and the wrong strategy if the market continues its uninterrupted rise. We have been more on the side of capital preservation and this has penalized us. However, many of our clients have recent painful memories of the market drop and prefer our approach. Indeed the current decade appears to have locked in the honor of being the worst decade ever for the S&P 500 which dates to the end of 1927 The second worst decade since the Depression was the 1970s, the period of the oil shock, but the current decade is so much worse, it would take a monster rally in the next three months, to pull even with the 70's, in spite of this year's exuberant rally.

We remain underweight financials as they still have serious problems ahead of them. We are overweight healthcare, which has hurt our performance as Obama Care has depressed healthcare stocks. However, we believe that these stocks, which are currently priced low relative to the S&P should do well. In order to reduce volatility and risk, we are also underweight Technology, which has hurt us. So, in order to reduce volatility and risk our cautious strategy has cost us some performance, but protected us on down days. Overall, we are up.

We appreciate the opportunity to be your investment manager, and look forward to talking with you at any time.

Best personal regards,

William D. Rutherford, President
Rutherford Investment Management LLC.

Information herein is believed to be reliable and has been obtained from sources believed to be reliable, but accuracy and completeness cannot be guaranteed. Opinions, estimates, and projections constitute our judgment and are subject to change without notice. Investing should only be considered for long-term goals as values fluctuate in response to the activities of individual companies and general market and economic conditions. Not every investment decision or recommendation made by Advisor will be profitable. Investment involves risk and may result in losses.