



THE FOXHALL GLOBAL OUTLOOK



JANUARY 15, 2009

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Dear Paul,

Now that 2008 is over, how do you see the economy and stock market performing in 2009 and beyond?

THE CARNAGE OF 2008 HAS BEEN NOTHING SHORT OF BREATHTAKING!

2008 was a horrible year. Virtually every stock market asset class crashed simultaneously.

The DOW had its worst losing year since 1931 when the Great Depression was in full swing. The S&P 500 INDEX was down 38.5% in 2008, the worst stock market drop since 1937 and the third worst drop in the history of the US stock market. That easily makes 2008 the nastiest annual decline ever experienced by most current investors.

HERE ARE JUST A FEW DISMAL FACTS FROM 2008:

- According to the WASHINGTON POST, the average financial fund lost 42% in 2008. (“Bleak Year Brought Almost No Winners,” January 11, 2009, WASHINGTON POST)
- We’ve lived through the biggest housing crisis since the Great Depression. In 2008, housing prices fell 23%. In 2009, analysts predict they will fall another 15% to 25% before bottoming out in 2010.
- In 2008, Americans suffered an epic destruction of wealth.
- Last year’s financial meltdown demolished American’s savings, wiping out over \$2 trillion in 401k’s and IRAs and another \$2 trillion in pension plans. A total of \$4 trillion in US retirement investments just simply disappeared!
- Average investors, lost another almost \$4 trillion in non-pension assets.
- If you then add the nearly \$10 trillion of wealth that was destroyed in the US housing market and another \$5 trillion in hedge funds and alternative investments and we

have witnessed almost \$23 trillion in wealth that simply evaporated in 2008.

- With employment numbers dropping, consumer sales, capital spending by the corporate sector, the collapse of home building and residential & commercial real estate, coupled with a now global recession—all this makes for very depressing reading.

THE ECONOMY IN 2009

As I have often said, and several studies have shown, in the long-run, the stock market ALWAYS FOLLOWS the underlying trend of the economy. If the underlying economy is expanding and growing and company profits are generally going up, then over the long-run the stock market will be up 100 percent of the time.

BUT conversely, if the underlying economy is contracting and company profits are generally going down, then OVER THE LONG-RUN THE STOCK MARKET WILL GO DOWN 100 PERCENT OF THE TIME.

In the entire history of the stock market, we have never had a bear market/recession where the broad stock market went up during the same period.

The stock market often measures whether the economy is growing or contracting by watching corporate earnings. However, according to STANDARD & POORS, earnings for S&P 500 companies are down 60% year-over-year going into 2009. MORGAN STANLEY predicts corporate earnings declines in 2009 will leave S&P 500 companies’ profits below those of 2007.

BASED ON THESE PRINCIPLES . . . I BELIEVE THAT THE ECONOMY AND THE STOCK MARKET IS SET TO DECLINE FURTHER IN 2009! The stock market will

probably be lower than it is now by the end of the year.

COMMODITIES AND GOLD

After a year of bouncing around, gold may be poised to rise against all major currencies. We could easily see new highs in the next year.

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I also believe oil and energy stocks could begin to rise once again near the end of 2009.

As for the other metals, I think it is quite likely copper and its industrial allies will fall in price at least for the near term, until production can be cut and demand in Asia begins to rise again.

ASIA & OTHER EMERGING MARKETS

Someday the bull market in commodities will return, but not until Asian demand picks up.

China and the rest of Asia are the only areas of the world creating real growth—not as much as last year—but still real growth.

I believe Asian stock markets may recover right before the U.S. and Europe. So watch for an Asian recovery in late 2009 or early 2010, followed by a recovery in commodities and then a turnaround in the U.S. stock market.

THE FOXHALL WAY: ACTIVE INVESTMENT MANAGEMENT

We were so pleased that FOXHALL CAPITAL was able to move our clients into a DEFENSIVE INVESTMENT STRATEGY in 2008 and we were largely able to protect much of their investment principal from the massive losses of the stock market last year.

WE INTEND TO DO THE SAME THING IN 2009. If there is a BEAR MARKET RALLY after the inauguration of President Obama as many experts are predicting, FOXHALL's process will respond and we will participate in that rally if it shows even a discernable trend over the next few months.

But, I believe this will be a short-term rally and FOXHALL's process will again respond and quickly move back into U.S government Treasury bond funds as soon as the rally is finished.

This is the benefit of having active investment managers with a disciplined process like FOXHALL CAPITAL watching your investment portfolios everyday. When something happens in the markets over any period of time—whether good or bad—we will take corrective action.

AS TV'S JIM CRAMER HAS SAID: "BUY & HOLD INVESTING IS DEAD!"

I feel sorry for all the people who believed the banks, stock brokers and mutual fund companies promoting BUY & HOLD INVESTING STRATEGIES.

In inflation-adjusted terms, the stock market is now about where it was in 1973! If you reinvested dividends, that gets you to 1991 (again, inflation-adjusted).

For American investors it has been a lost decade. After two booms and two busts, stock markets have earned them nothing, or less than nothing, in the past 10 years.

According to MORNINGSTAR, an American who has diligently put \$100 a month into a domestic equity mutual fund for the past 10 years (through November of 2008), will find that their investments are now worth less than they put into it. They would have accumulated \$10,932—\$1,068 or about 10% LESS than they had originally invested with their



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monthly contributions.

My big concern is that so many Americans have lost so much money with their BUY & HOLD INVESTMENT STRATEGIES, that I fear many investors will just capitulate as the stock market gets worse later in 2009 and they will sell all of their stocks and swear off the stock market forever.

THAT WOULD BE A VERY SERIOUS MISTAKE!

THE GREAT STOCK MARKET COMEBACK IN 2010!

When this bear market/recession ends, be prepared for a fast and furious recovery.

That is an important reason to look past the current chaos. Historically, the stock market comes roaring back after steep stock market downturns. NED DAVIS RESEARCH looked at the ten U.S. recessions since World War II and found that the average market return one year after the market's low point was 32%. That is the kind of recovery rally no investor wants to miss.

According to S&P CAPITAL, in each of the last four recessions, the low point for stocks gave way to five-year returns of 14% annually on average, which is much better than the 9% average annual return historically derived from stocks.

If history is a guide, we are approaching one of those rare excellent buying opportunities.

It is sometimes human nature for us to view our own difficulties as "THE WORST OF TIMES." This painful but necessary correction will eventually result in a healthier, deleveraged society with a renewed focus on productivity, innovation, and better governance. The end is not here yet, but a new beginning will be here in about a year.

I AM LONG-TERM BULLISH ON AMERICA

As they say, there is always a silver lining even in the darkest of clouds. The same is true for severe economic recessions. What doesn't kill you, makes you stronger, and recessions have often generated greater innovation out of the ashes of a bad economy.

Economic weakness has historically inspired more innovation. At the end of the day, positive things will come out of this crisis.

It is going to be positive in two respects. One is that recession is often a stimulus for the adoption of new technologies. The decade of the highest productivity growth in the 20th century was the 1930's. In the 1930's a lot of technologies, developed in the 1920's, were put into use because people were looking for any angle to improve their productivity.

The personal computer revolution took off in the really terrible recession in the early 1980's. I predict, after this recession, we are going to see an awful lot of innovation in the health-care sector because people will be driven to cut costs.

So, even right now, a great advance could be taking place that in the long run will revolutionize health care for everyone. And in the end, that will have a much more lasting impact on the economy than whether the recession lasts a few months more into 2010.



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I also see another “positive” coming out of this recession. The U.S. has been living in a situation of excess for too long. Americans have overindulged—borrowing from the rest of the world to pay for faster cars, bigger houses and smaller cell phones.

Now we have to tighten our belts and save more.

We will dig out of this. And when we do, I hope for a back-to-basics society—where banks and other lending institutions promote real growth and long-term value for the economy, and where American families have rediscovered the peace of mind of financial security achieved through saving and investing wisely.

We need to return to a culture of thrift that many of our parent’s generation learned the hard way through years of hardship and deprivation. Those are lessons learned that the current crisis is teaching us once again.

Lastly, we have to channel more resources to parts of the economy that are more productive.

The question we have to ask ourselves is; what do we really value most in our society? Unfortunately, up until now the answer has been “WHO DO WE PAY THE HIGHEST SALARIES TO.”

Well, I think we need a lot more civil and computer engineers and scientists and doctors and educators, a lot fewer lawyers, investment bankers and people who make millions of dollars a year doing financial engineering.

In the future, Americans will eventually return to their productive heritage. It will once again create goods and services that the rest of the world wants instead of paying for imports with IOUs.

China and other emerging markets countries will devote more of their awesome productive capacity to raising the living standards of their own citizens.

If we can start to look past the current crisis and see the future—IT IS AS BRIGHT AS EVER!

NEXT WEEK....

Next week, I will explain in some detail just how FOXHALL CAPITAL will continue to manage our client’s investments in 2009, using our FOXHALL DEFENSIVE INVESTMENT STRATEGY.

UNTIL THEN...

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