FAI Advisors, Inc.

Monthly Investment Commentary

January 2009

Model Portfolio Commentary

Solid returns for stocks and bonds in December provided little relief in a year that will go in the books as the worst in decades for financial assets. While equity returns varied widely in the month, fourth-quarter and full-year returns were comparably dismal for most equity asset classes. The Vanguard 500 Index Fund, a proxy for large-cap U.S. stocks, gained 1.1% in December, but lost about 22% and 37% for the fourth quarter and calendar year, respectively. Smaller-caps closed the year with a strong 5.9% December gain for the iShares Russell 2000, but losses for the quarter were 26% and for the full year the index was down 33.7%.

Updated Market Data

	December	YTD
Large Cap Benchmarks		
Vanguard SP 500	1.10%	-37.00%
Russell 1000 Growth ishares	1.80%	-36.80%
Russell 1000 Value ishares	1.40%	-36.80%
Small Cap Benchmarks		
Russell 2000 Growth ishares	5.50%	-38.40%
Russell 2000 Value ishares	6.30%	-28.70%
Other Benchmarks		
Vanguard REIT Index	17.40%	-37.00%
Vanguard Total Intnl Stock Idx	8.20%	-44.10%
Vanguard Total Bond Idx	3.30%	5.10%
Merrill Lynch High Yld bond Idx	7.60%	-26.20%
Citigroup World Govt Bond Idx	7.10%	10.90%
DJ-AIGCI (Commodity Futures)	-4.50%	-35.60%
Barclays Credit Bond Ishares		

"A Year in Review"*

	12/31/08	12/31/07	% Chg
Consumer Rates			
1 Year CD Yld	1.70%	4.20%	-59.52%
30 Yr Mortgage	5.07%	5.73%	-11.52%
Prime Rate	3.25%	7.25%	-55.17%
Commodities			
Crude Oil	852.45	877.40	-2.84%
Gasoline	40.66	95.61	-57.47%
Gold	1.68	3.05	-44.92%

* Source: JP Morgan Weekly market recap

Aided by dollar weakness, foreign stocks saw very strong gains in December, with Vanguard Total International Stock Index Fund gaining 8.2%. The 21% fourth-quarter loss was not as bad as U.S. stocks, but for the full year the Vanguard fund was down 44%, about seven percentage points worse than domestic equities. Domestic bonds had a good showing in December, with the Vanguard Total Bond Market Index Fund gaining 3.3%, which was enough for a very solid 4.4% gain in the fourth quarter and a 5.1% gain for the year. Among other asset classes, returns varied widely. The Merrill Lynch High Yield Master Index rebounded strongly in December after reaching record-level yields, with a 7.6% gain, and REITs, which have also been plagued by concerns about access to credit, shot up 17.4% for the month. However, both finished the year with big losses: high yield lost 26% and REITs fell 37% in 2008. The commodity futures asset class was the only loser among those we follow, with a 4.5% loss in December.

Here are a few quotes worth noting from this very interesting year:

Warren Buffet (September) "last week we were on the brink of financial history with a system that was totally dysfunctional"

Mohamed El-Erian of PIMCO, Ex-Harvard University Endowment (October) "it was the worst day in emerging market debt in 67 years."

Alan Greenspan (October) "we are in the midst of a once in a century credit tsunami."

Ken Griffin of Citadel, Chicago based hedge fund with a sterling performance record prior to 2008 (November) "We specifically designed Citadel to be prepared for almost any market calamity. The idea that the largest banks in the world would simultaneously fail, need government support, government guarantees, and/or government intervention to survive was not in our range of realistic scenarios."

Henry Paulson (November) "with the financial system on the verge of collapse, our clear objective when we went to Congress was to stabilize it through measures that would increase capital strength."

Investment Review and Outlook

For investors, 2008 was a once-in-a-lifetime train wreck. The year was arguably the most painful in modern investment history (it was the worst year for the stock market since 1931). We did give weight to the likelihood of very negative scenarios playing out in fall 2008. While we made tactical (asset allocation) adjustments to significantly reduce our portfolios' risk exposure. They were not enough. As the year progressed we became more troubled about the continuing credit crisis and the possibility that it could trigger a nasty recession that could be followed by a multiyear period of subpar growth. Earlier in the year we put a low probability on the more extreme ways this could play out. However, by mid-September, with major financial institutions falling like dominoes and the money markets freezing up it became clear that we had to adjust our thinking in light of both the severe market declines and challenges facing the global economy that went beyond what most investors have experienced in their lifetimes. At that point we realized that the pessimistic scenarios we considered as possible outcomes were becoming probable outcomes. This led us to a realization, which was that unlike almost every bear market of the past 50 years, automatically buying stocks after a 20% decline might not be sensible. Clearly we are in the midst of a severe recession. Beyond that we also now believe it is not just possible, but likely, that we will experience several years of slow economic growth as consumers adjust to a new reality in which they finally have to pay down debt and increase savings (and thus spend less than in the past). The time has finally come for the growth in household debt to slow or reverse. If the environment plays out as we believe it could, it may take a number of years after the recession ends for corporate earnings growth to return to its long-term trend, and the recession itself could last through 2009 or even into 2010.

What the Future Might Look Like For Investors

Downside risks remain. However, the huge fiscal and monetary stimulus that is likely to carry on beyond the next year should be a major offsetting factor that will provide support to the economy. Still, the recession will be one of the worst of the post-WWII era and could turn out to be the worst since the 1930s. After it ends, we believe it will take quite a while for economic growth to get back to its long-term trend level.

In the near term of 2009, as the Fed and the Treasury take whatever actions are necessary to make this happen it is possible that we will see direct government purchases of corporate bonds. We believe that credit markets will improve over the course of 2009 and if we are right it will be a good year for bonds. During the Great Depression, the economy contracted for three years and seven months. Something to keep in mind, the market has on average, bottomed 5 months before the end of a recessionary period, but we just don't know how long this will take to work its way through. Currently, we are focused on the opportunities that have presented themselves. It is also critical to manage through this taking into consideration what happens after this is over, i.e.: the potential future "hangover" of the current fiscal and monetary stimulus actions (additional weakened dollar and inflation).

Confidence in the System

While it is bad enough to experience drops in the values of our assets, it is troubling to see miss-management of resources in Washington, and lack of oversight of regulators. In speaking specifically about the Bernard Madhoff fraud scheme, this has got to be not only the worst timed, but one of the most blatant examples of violation of the public trust. Madoff's auditors Friehling & Horowitz were accredited by the SEC and all the investment vehicles were audited by the largest auditing firms. Despite the supposedly size weakness of Madoff's auditors, the SEC has each year renewed its approval; SEC reports on the firm were regularly made available.

Our response to this: First of all, we have NO DIRECT EXPOSURE to anything related to this issue. Secondly, in managing assets, we hold assets in client accounts that we understand. There are far too many advisors that find exotic investments that are supposed to do some amazing things, and they place them in client accounts, having very little understanding as to what they are. It is not so much what is owned, it is how we use it. Uncomplicated investment holdings can yield great results if used properly. Finally, this is a result of regulatory incompetence, and we are diligently following regulatory procedures. There is a wave of regulatory hypersensitivity coming from Washington, and the scrutiny on firms like ours will dramatically increase. While this will burden our time and resources, we welcome this if it gives the public some level of trust again. It is unacceptable to us that our clients have any doubts about where assets are, and what is owned. If you have any concerns at all, we want you to ask us. The markets have been difficult enough to deal with.

We'd like to leave you with a couple of thoughts. Very difficult market environments like we are seeing now tend to create compelling opportunities and ultimately reward skilled and disciplined active management. We are using this to question ourselves and learn how we can be better—something that we are always striving to do. This process allowed us to identify areas for improvement in some of our asset class work and models and we will be communicating this in review meetings and newsletters. We're excited about our enhanced asset class models and improvements, and believe they will further sharpen our decision-making. Also, in extreme periods of declines (like now) and exuberance (1999), we can tend to be emotionally driven, both clients and advisors. We are committed to doing what we believe is right for our clients regardless of the near-term consequences to our business. We are fully aware that the future of our business comes from first caring for those we serve. We know that 2009 and beyond will remain challenging, but we believe we are well equipped to navigate treacherous waters.

We remain strongly committed to focusing everything we do on rewarding you for your confidence.

FAI Advisors, Inc.
Investment Policy Committee (01/22/09)

FAI Advisors, Inc.

39395 W. 12 Mile Road · Suite 102 · Farmington Hills, MI 48331
Phone: 248.482.3600 Fax: 248.482.3611
www.financialarch.com