



Baldwin Investment Management, LLC

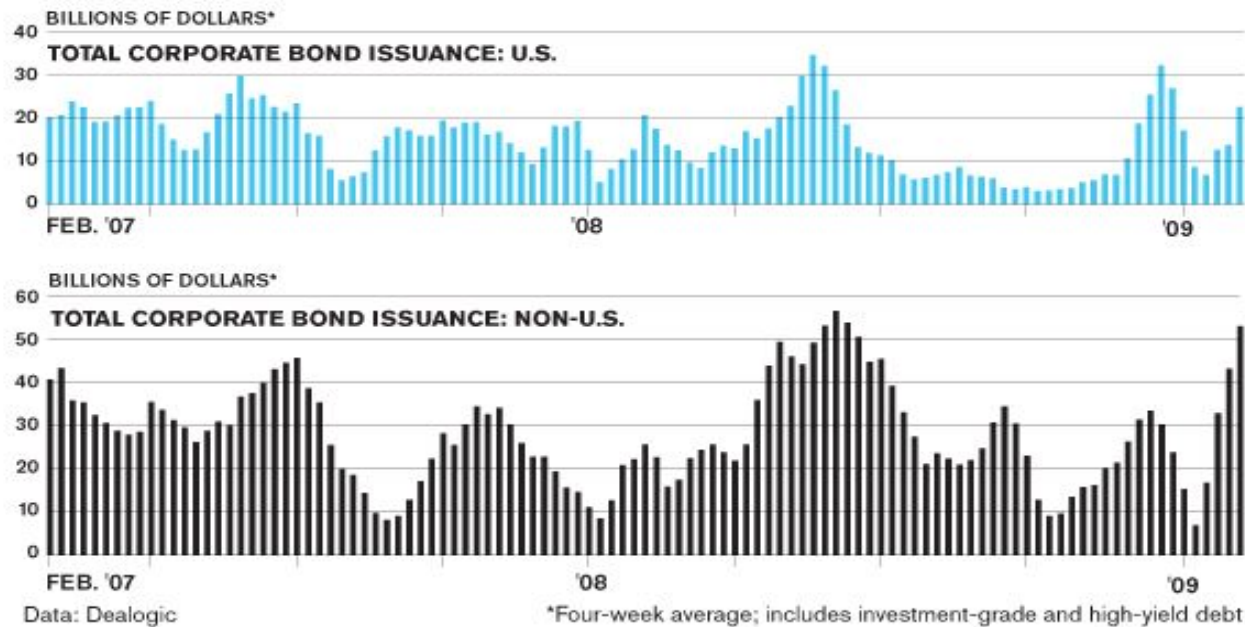
EMBERS

The daily economic news is distressing. Gloom permeates. It seems that every day a company announces a significant layoff. Home foreclosures continue to mount. Corporate earnings are down versus last year for most companies. Dividends have been cut by some corporations. Business activity around the world has deteriorated. In fact, with some exceptions economies around the world are slipping into recession. As a side show, politicians preen before cameras expressing sympathy for the displaced, while at the same time, lambasting former “Masters of the Universe” for engorging themselves and associates with bonuses while having a hand out for taxpayer money. Meanwhile, investors are searching for a “bottom” in the markets and in the economy. They are looking for the light at the end of the tunnel.

We would like to point out that it is human nature to extrapolate the most “recent experience” when trying to predict the future. This is why “extremes” get created, either on the “upside” or on the “downside”. For example, during the summer of 2008 as oil prices were topping \$130/barrel (bbl), an analyst at Goldman Sachs proclaimed that oil prices would spike to \$200/bbl. As we all know, oil never came close to that \$200 figure and now sits at approximately \$40/bbl. But at the time, as oil was climbing rapidly, it seemed like a very reasonable prediction due to the “recent experience.” Similarly, last summer, inflation was considered by most pundits to be the “cause célèbre” for analytical worry. Now, a mere few months later, deflation reigns uppermost in most experts’ minds. “Recent experience” can be very dangerous as a predictive tool for making investment decisions.

The present trend is DOWN according to most publications or “talking heads”. Forewarned that trend following can be dangerous to one’s investment well being, let us examine several embers still glowing in a fire thought by quite a few to be

extinguished. Very importantly, the bond markets in the U.S. and around the world have reopened for business. Investment grade companies have sold more than \$132.8 billion in bonds so far in 2009 – 22.6% more than in the same period of 2008.



Source: *Business Week*, 2/23/2009

Even “junk” rated companies have found success in the revitalized bond market. Since last November, individual investors have poured \$4 billion into “junk” bond funds. Banks have begun lending to one another. As recently as last fall, inter-bank lending had completely frozen shut. So this is a BIG turn of events and is most easily recognized by the sharp decline in LIBOR, (the rate at which banks lend to one another), falling to approximately 1.3% vs. in excess of 4% in the late fall. Banks are now more confident with one another. The interest rate they demand on lending has declined, reflecting the perception of reduced risk.

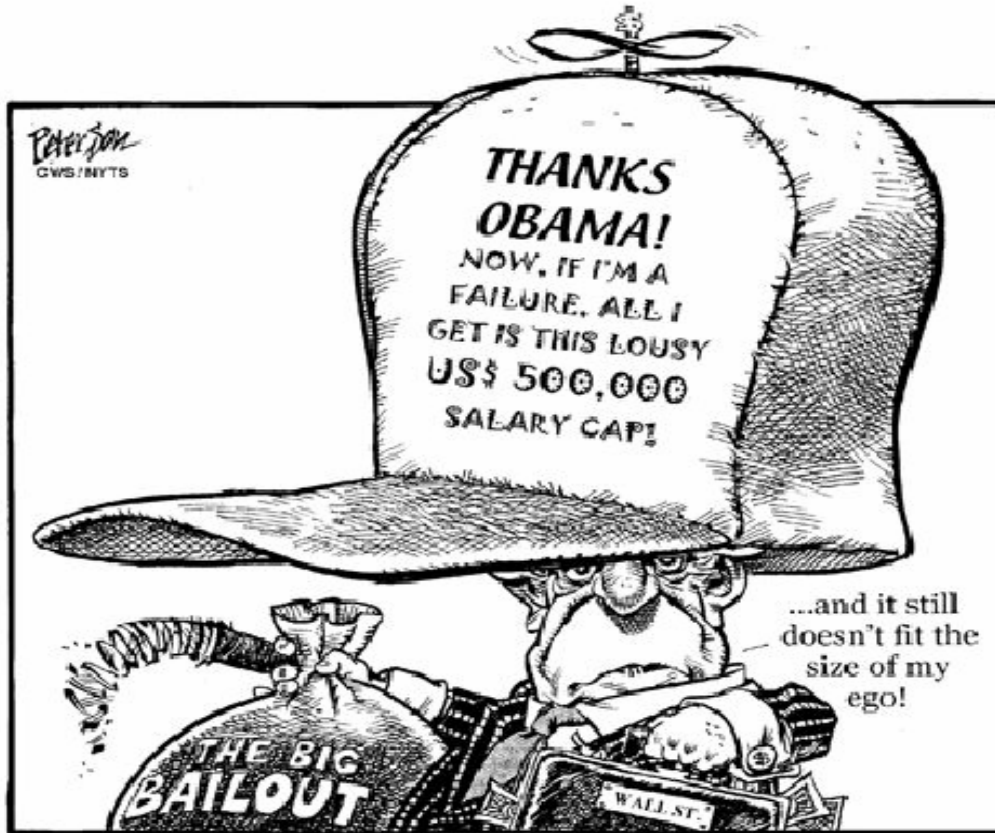
There is a “sea of money” waiting for the investment “flag” to go up, thereby giving investors the “all clear” sign. It is important to note that money market fund assets are close to hitting a record of \$4 trillion. This is a figure which approximates the market capitalization of all U.S. stocks, giving us the sense that there is plenty of fuel to ignite a market rally.

Here is another positive example that not all is gloom and doom. The Baltic Dry Index has advanced quite sharply. Granted, the rise is off a very low base and the Index is still down sharply from its peak last year – but this is an important change of trend. The Baltic Dry Index reflects chartering rates for container ships which ply the world’s trade routes. When ships are busy, the index goes up reflecting increasing charter rates as a result of increasing trade. On the other hand, if ships are idle, spot charter rates fall, as does the Index. Late in 2008, as business around the world began to “seize up” charter rates plummeted and so did the Index. In 2009, there have been some stirrings on the “high seas” – more business is obviously getting done, because more ships are being chartered.

Housing, as acknowledged by most everyone, is where “the problems” started and is still the epicenter for the turmoil. Housing starts have cascaded from in excess of 2.1 million units per year in 2007 to less than 700,000 units per year presently, (a run rate less than that in 1975), while inventories of unsold new homes have decreased 35% since July 2006. Further, mortgage payments on the average home approximate 16% of household income and are lower today than in 1975. Total housing inventory, which includes not only new homes but also foreclosed homes, is still too high – but is obviously coming down. In fact, experts have said that housing stock being built today does not match demand from new household formation. Until the price of housing is perceived generally by the market to have stabilized, we will continue to have difficulty. The Obama administration is about to present some specific ideas to help homeowners. Happily, it would seem that our leaders’ focus has now turned to this particular problem.

We believe that the “fire” has not gone completely cold. There are “embers” still alight. Many investors today realize with their brain that there are values in most any market which have not been seen for years. However, no matter that their “long term” brain says that it might be time to begin to commit capital, their “short term” gut feel says it is still time to be conservative. Emotion still rules in this market. Like trend following or “recent experience”, emotional investing can be hazardous to one’s long term performance.

A FINAL THOUGHT



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2/17/09