

CURRENT STOCK MARKET ENVIRONMENT AND A HISTORICAL PERSPECTIVE

“Buy stocks like you buy groceries, not like you buy perfumes” -Warren Buffett

As I pen this letter, I don't see a lot of grocery shopping around in the stock markets around the world, although the shopping could begin at a moment's notice. We are in the throes of one of the largest declines the U.S. stock market has seen in decades. Market volatility is at record levels, sentiment is downright depressing, the markets appear to have priced in a really long and deep recession, unemployment trends are not encouraging, and the list goes on. But surely, we have been there before in some form and a look at the last few down market environments (using the S&P500 Index as a proxy for the U.S. stock market) in the last three decades reminds us of this.

Table No. 1: Recent Down Market Environments

Period	Peak to Trough S&P500 Loss	Duration (days)	Precipitating Events/ Environment
Jan 73 - Oct 74	-48.20%	630	Watergate scandal, Arab-Israel war, Oil embargo, Inflation, and Recession
Sept 76- March 78	-19.40%	531	Stagflation threat
Sept 78- March 80	-8.20%	562	Stagflation; Annual inflation hitting a peak of 14.5% by April 1980
Nov 80 - Aug 82	-27.10%	622	High interest rates, Recession
Oct 83- July 84	-14.40%	288	Return of inflation
Aug 87 - Dec 87	-33.50%	101	Black Monday
July 90 - Oct 90	-19.90%	87	Recession, Iraq war
July 98 - Aug 98	-19.30%	45	Long Term capital Management collapse
March 00 - Sept 01	-36.83%	546	Dot-com bubble burst, Recession
Jan 02 - Oct 02	-33.80%	278	Accounting scandals: Worldcom, Enron
Average	-26.06%	369	
Median	-23.50%	409.5	
Oct 11, 2007 - ?	-44.40%	378 days and going	Housing bubble burst, Credit/Financial crisis, Recession

Sources: Yahoo, Reuters

The current state of affairs in the financial markets should come as no surprise to students of market history. While the table above (as of 10/24/08 close) does not provide insights about when the current crisis will end, it does offer a couple of important pointers. First, we tend to dig holes of varying depths from time to time, at least once every decade—human greed usually takes care of that. Second, there is always light at the end of the tunnel—sooner or later we tend to get out of the holes we dig. The U.S. government is giving a big helping hand this time and if history is any indication it would not be prudent to fight its intentions, especially given the intensity of these intentions and the extensive arsenal of tools that it has assembled over the years. It is extremely difficult however, to predict and anticipate consistently when such tough market environments can creep up on us or when they will suddenly disappear. How we navigate such difficult times will no doubt determine the kind of investment success we can derive

from the stock market over the long term. As Buffet rightly noted recently, the markets are likely to move higher well before either the sentiment or the economy turns. We strongly believe that this current financial storm too will pass and the time has come to start stocking up on some good quality, under priced groceries!

OUR PERFORMANCE YEAR TO DATE

To say that 2008 has been a difficult year thus far for most money managers would be a gross understatement. Being down 20% or so year to date through last Friday (10/24) would have placed a money manager in the top 1 percent of most equity mutual fund categories as tracked by Morningstar. While I am averse to drawing too many conclusions from short performance periods, outperformance relative to the market during bear market periods does indicate to some degree how well the investment philosophy behind managed assets can withstand bear markets.

While I am modestly encouraged about the relative performance of the Ceera Capital Appreciation Model Portfolio (which is a virtual portfolio that mirrors the investments of our typical Capital Appreciation client and henceforth called the “Model”; for more details/disclosures on the Model please visit: <http://www.ceera.com/pdf/modelportfoliodisclosures.pdf>), the absolute performance is nothing to cheer about. Although the Model’s performance is ahead of the S&P500 index by almost +14% on a year to date basis (ending 10/24/08), we are still down for the year, i.e. -25.4% versus -39.2% for the S&P500 index. Unfortunately, we are all boats in the same ocean and one can expect to be hurt in down markets such as the current one. As I have stated to our clients before, I would expect the performance of our Capital Appreciation oriented portfolios to do relatively better during bear markets, owing to our generally conservative buying criteria and investment philosophy. As shown in Table No. 2 below, on a year to date basis, the Model has performed respectably relative to the equity mutual funds universe—domestic and international.

Table No. 2: Year to date (YTD) Performance of Ceera Model Portfolio

Morningstar Category (Domestic Diversified Stock Funds, ex Speciality)	YTD Percentile Ranking of Ceera Model
Large Blend	1%
Large Growth	1%
Large Value	1%
Mid-cap Blend	1%
Mid-cap Growth	1%
Mid-cap Value	2%
Small-cap Blend	1%
Small-cap Growth	1%
Small-cap Value	4%
International/Global Stock Funds (all categories)	1%

Sources: Morningstar.com

Our efforts will continue to be to minimize the downside on a long-term basis and position our investments for the upswing that will eventually come.

A NOTE ABOUT MARKET TIMING

As investors weed through the likely destruction in paper values in their portfolios, one of the thoughts going through their minds is likely to be the thought of rushing to the safety of cash during times like these. Many might wistfully

wonder why they didn't move to cash before the stock market swoon and some who have done so are likely to be patting themselves on their backs. Warren Buffett had the following to say (in an October 17th NY Times Editorial) about cash and rushing to safety in the current environment:

"Today people who hold cash equivalents feel comfortable. They shouldn't. They have opted for a terrible long-term asset, one that pays virtually nothing and is certain to depreciate in value. Indeed, the policies that government will follow in its efforts to alleviate the current crisis will probably prove inflationary and therefore accelerate declines in the real value of cash accounts. Equities will almost certainly outperform cash over the next decade, probably by a substantial degree. Those investors who cling now to cash are betting they can efficiently time their move away from it later. In waiting for the comfort of good news, they are ignoring Wayne Gretzky's advice: I skate to where the puck is going to be, not where it has been."

For those of you who believe that the markets can be timed efficiently, I would like to provide some food for thought by trying to illustrate how difficult it can be to move in and out of the market successfully, i.e. time the market by being invested or by being fully in cash. Table No. 3 below shows the performance of the U.S. stock market (as indicated by the return of the S&P500 Index) from 1966 to 2000. This table also shows what the performance would have been like in a given year if one had missed out on the 5 best days during that year ("Without 5 Best Days" column). While the data is not current through 2008, I believe it still tells a compelling story about market timing.

Table No. 3: Dangers of Market Timing

Year	Annual Performance of S&P500 Index (1)	Without 5 Best days	Difference	Year	Annual Performance of S&P500 Index (1)	Without 5 Best days	Difference
1966	-13.09%	-21.55%	-8.46%	1984	1.40%	-10.64%	-12.04%
1967	20.09%	11.66%	-8.43%	1985	26.33%	15.17%	-11.16%
1968	7.66%	-1.16%	-8.82%	1986	14.62%	3.41%	-11.21%
1969	-11.36%	-18.64%	-7.28%	1987	2.03%	-20.09%	-22.12%
1970	0.10%	-13.65%	-13.75%	1988	12.40%	-2.70%	-15.10%
1971	10.79%	0.26%	-10.53%	1989	27.25%	14.79%	-12.46%
1972	15.63%	8.42%	-7.21%	1990	-6.56%	-17.82%	-11.26%
1973	-17.37%	-27.23%	-9.86%	1991	26.31%	10.05%	-16.26%
1974	-29.72%	-42.38%	-12.66%	1992	4.46%	-2.95%	-7.41%
1975	31.55%	15.86%	-15.69%	1993	7.06%	-0.90%	-7.96%
1976	19.15%	9.83%	-9.32%	1994	-1.54%	-9.16%	-7.62%
1977	-11.50%	-17.30%	-5.80%	1995	34.11%	25.14%	-8.97%
1978	1.06%	-10.12%	-11.18%	1996	20.26%	9.78%	-10.48%
1979	12.31%	2.17%	-10.14%	1997	31.01%	11.98%	-19.03%
1980	25.77%	11.09%	-14.68%	1998	26.67%	4.54%	-22.13%
1981	-9.73%	-20.06%	-10.33%	1999	19.53%	3.98%	-15.55%
1982	14.76%	-4.49%	-19.25%	2000	-10.14%	-25.28%	-15.14%
1983	17.27%	5.12%	-12.15%				
Sources: Barrons				Average			-12.0%
(1) Excludes dividends				Median			-11.2%
				Total Returns (1966-2000)	1328.3%	-77.6%	

Without the best five days in a given year, on average one would have underperformed the continuously invested scenario by 12%/ year and on a total compounded basis the underperformance would have been to the tune of 1405.9%. Now, one may believe at the bottom of one's heart that this time is different and that timing the market will work this time around and that it is possible to ensure being invested only during all or most of the time that the market is having good days in a given year. But, probabilistically it sure is a tall order to successfully time your entry in and out of the markets—you miss out just 5 of the best days during the year and you are highly likely to start lagging the market. While there is no doubt a 20/20 hindsight element to timing the markets, I hope the above illustration has

highlighted the difficulty and danger associated with making the two decisions (that of getting completely into cash or being invested for the most part) accurately as opposed to staying the course.

The only timing we like to indulge in is from an individual holding/ business valuation and opportunity costs/return perspective wherein we are willing to buy an investment at an attractive discount to a conservatively calculated intrinsic value for the security and are willing to exit an investment when a) it has reached close to or above our conservatively calculated intrinsic value for the business, or b) a more attractive investment opportunity comes along. Sticking to this rational approach over time and across a portfolio, we believe, will produce returns with acceptable downside risks over the long term. Along the way it is likely that we will make mistakes but it is our hope that this conservative approach will minimize such mistakes and that our successes will outnumber our mistakes.

CONCLUSION

In conclusion, we are firm believers in Warren Buffett and his philosophy and are inclined to follow his advice at this crucial juncture. We continue to stay the course with our undervalued investments and are looking for the babies that have been thrown out with the bathwater in this current environment. I look forward to hearing from you if there are any questions or clarifications.

Sincerely,
Rajesh Chelapurath