

May 27, 2008

TO: All clients and interested parties
FROM: Bob Kargenian

This quarter, we're taking a look at down market cycles and how the past relates to the current environment, along with the concept of maximum draw down and why it's important investors understand this concept in relation to expectations. Also, there is a note on client referrals/new business and a look at first quarter performance.

In addition, we've enclosed a reprint (with full permission) of an article that appeared in **Retirement Weekly**, a service of CBS Market Watch. I felt it had relevance to many of our clients, and is simply titled "If you loved your wife." Read on.

If You Loved Your Wife

As the editor noted in his preface, I can also attest from personal experience that many widows and would-be widows have little, if any, experience managing money. That is not to say, ladies, that the men are any smarter. I can assure you, that is not necessarily the case. My belief is simply that is the way our culture has evolved and reflects the typical roles of men and women in marriages and domestic relationships.

According to the survey noted on page 2 of the article, among women who are married or are in a domestic relationship, only 33% have talked in depth with their partner and have a plan for being financially prepared for retirement, and just 31% have a plan for being financially protected if their spouse should die. One of our objectives for the clients of TABR is to make sure they are in this group, and not in the 67% segment that have no plan.

Though investment management is certainly the most interesting aspect of our job, and our risk management approach differentiates us from most everyone else, it is important to remember all of the areas we are covering with clients. They include:

- Estate Planning guidance and implementation
- Life Insurance Planning
- Retirement Planning
- Investment Management

In addition, we act in a fiduciary capacity for clients and eat our own cooking (meaning virtually everything we do with clients' money, we are doing with our own—we have a strong, vested interest).

Down Market Cycles/Secular Bear Markets

Wall Street, many of its advisors, and many members of the media like to emphasize the fact that since 1926, large company stocks as represented by the S&P 500 have compounded at about 10.5% annually. That is a true statement, and it tends to be used in the context of conveying that in the long run, stocks have provided the greatest inflation-adjusted return of any asset class. Unfortunately, that statement can also be as useless as stating that Charles Manson is a man. With both, there is more to the story.

The truth is, stock returns move in cycles, tied to valuations. In the 1980's and 1990's, large company stocks compounded at over 16% annually. But many people, investors and advisors alike, either don't know or don't remember that the 1960's and 1970's were quite different. In fact, as I'm about to show in the table below, that time period was very similar to what has happened recently—the last 8 to 9 years.

YEAR	LARGE	SMALL	INT BOND	40L/20S/40B	60L/40B	50L/50B	40L/60B	25L/15S/60B
1960	0.47	-3.29	11.76	4.23	4.99	6.12	7.24	6.68
1961	26.89	32.09	1.85	17.91	16.87	14.37	11.87	12.65
1962	-8.73	-11.90	5.56	-3.65	-3.01	-1.59	-0.16	-0.63
1963	22.80	23.57	1.64	14.49	14.34	12.22	10.10	10.22
1964	16.48	23.52	4.04	12.91	11.50	10.26	9.02	10.07
1965	12.45	41.75	1.02	13.74	7.88	6.74	5.59	9.99
1966	-10.06	-7.01	4.69	-3.55	-4.16	-2.69	-1.21	-0.75
1967	23.98	83.57	1.01	26.71	14.79	12.50	10.20	19.14
1968	11.06	35.97	4.54	13.43	8.45	7.80	7.15	10.88
1969	-8.50	-25.05	-0.74	-8.71	-5.40	-4.62	-3.84	-6.33
1970	4.01	-17.43	16.86	4.86	9.15	10.44	11.72	8.50
1971	14.31	16.50	8.72	12.51	12.07	11.52	10.96	11.28
1972	18.98	4.43	5.16	10.54	13.45	12.07	10.69	8.51
1973	-14.66	-30.90	4.61	-10.20	-6.95	-5.03	-3.10	-5.53
1974	-26.47	-19.95	5.69	-12.30	-13.61	-10.39	-7.17	-6.20
1975	37.20	52.82	7.83	28.58	25.45	22.52	19.58	21.92
1976	23.84	57.38	12.87	26.16	19.45	18.36	17.26	22.29
1977	-7.18	25.38	1.41	2.77	-3.74	-2.89	-2.03	2.86
1978	6.56	23.46	3.49	8.71	5.33	5.03	4.72	7.25
1979	18.44	43.46	4.09	17.70	12.70	11.27	9.83	13.58
1980	32.42	39.88	3.91	22.51	21.02	18.17	15.31	16.43
1981	-4.91	13.88	9.45	4.59	0.83	2.27	3.71	6.52
16 YEAR AVERAGE 1966-1981				8.24*	6.20*	6.22*	6.19*	7.75*
*represents 16 year compound return								

First, let me give you the definitions for the table—the raw return data comes from Ibbotson & Associates and their annual yearbook and includes reinvested dividends. The column labeled Large represents the S&P 500, the column labeled Small represents the Ibbotson Small Company Index and the column labeled Int Bond represents the annual return from Intermediate Government Bonds.

The columns to the right represent various asset allocation mixes. For instance, 40L/20S/40B represents 40% in large stocks, 20% in small stocks and 40% in bonds. Another example is 40L/60B, which means 40% large stocks and 60% bonds.

Though not shown in the summary row at the bottom, we calculated that the compound return for large company stocks from 1960-1969 was 7.8%, and from 1970-1979 it was 5.9%. We also emphasized the 16-year period from 1966 to 1981. Why? Because in 1966, the Dow Jones Industrial Average was at 1000, and 16 years later, it was trading below 800. That would be a secular bear market—a period of subpar returns (Webster’s Dictionary defines secular as “coming once in an age.”). In contrast, a secular bull market would be that of 1982 to 1999, when returns compounded at over 16%.

Despite the Dow Industrials going nowhere from 1966 to 1981, a portfolio of 60% large stocks and 40% bonds still compounded at 6.2% annually. That is because dividends were a large part of the total return of stocks during that time period. I should add that by including small stocks in the mix, you can see that returns were enhanced, though I will tell you I don’t really put a lot of trust in Ibbotson’s small company data. In addition, today one would want to diversify some of the equity allocation into international equities as well, but reliable data for this area is hard to come by for time periods prior to 1980.

Now, let’s compare the period of 1966-1981 with the most recent 9 years, 1999-2007. The following data represent compound annual returns over this period.

Vanguard Total International Stock Fund	8.77%
Vanguard Total Stock Fund	4.51%
Vanguard Total Bond Fund	5.39%
60% TotStock/40% TotBond	5.29%
45% TotStock/15% TotInt/40% TotBond	6.01%
Fidelity Cash Reserves	3.49%

Below is a table summarizing the down market cycles in the S&P 500 since 1926 (data courtesy of Leuthold Weeden Institutional Research).

Time Period	# Months	S&P 500 Total Return
September 1929 to June 1932	33	-86%
September 1932 to February 1933	5.5	-41%
July 1933 to March 1935	15	-31%
March 1937 to March 1938	13	-54%
November 1938 to April 1942	41	-45%
May 1946 to June 1949	36.5	-30%
August 1956 to October 1957	8	-22%
December 1961 to June 1962	6.5	-28%
February 1966 to October 1966	8	-22%
November 1968 to May 1970	18	-36%

January 1973 to October 1974	20.5	-48%
September 1976 to March 1978	17.5	-19%
November 1980 to August 1982	20.5	-27%
August 1987 to December 1987	4	-34%
July 1990 to October 1990	3	-20%
July 1998 to August 1998	1.5	-19%
March 2000 to October 2002	30.5	-49%

As you can see, these down moves have lasted anywhere from 3 months to over 3 years, and with the exception of the Depression era in the early 1930's, have ranged from -19% to -54%. The current down cycle, which began in October, has thus far resulted in an -18.6% drop in the S&P 500. If it is over, which remains to be seen, it lasted all of five months, bottoming in March.

The important thing to remember as an investor is, that for the past 80 years, there has been a significant decline in the stock market approximately once every 4 to 5 years. It is a normal part of investing, just like the growth of our economy is occasionally interrupted by recessions as part of the business cycle. If one does not know how to deal with these declines, they can be very hazardous to your wealth, and perhaps as importantly, your health. Which leads us to our next topic, that of Maximum Draw down.

Maximum Draw Down (And The Importance of Minimizing It)

As you can see from the above summary, if you followed Wall Street and the media's hype about buying and holding over the long term, twice in the past 35 years one would have seen their stock allocation lose nearly 50% of its value. Maximum draw down is defined as the loss that would have been incurred had one invested at the peak, and then measuring that peak to the trough, thereafter which markets began to recover. I should add that the NASDAQ, dominated by technology stocks in the late 1990's, lost over 70% of its value during the same two time periods.

I've yet to have a client tell us that they can withstand losing 50% of their portfolio as part of a normal investing process. Since most investors have 20 to 30-year time horizons, whether it is in the retirement phase of their lives or in the accumulation phase, it is very likely they are going to experience this at least once during their time. So, what does one do about it? I believe the answer lies in diversification coupled with risk management.

First, we don't as a rule recommend an all-equity portfolio, even for our most aggressive clients, but we can certainly accommodate it. So, realistically, one should first be looking at what was the worst loss with a balanced portfolio?

If you'll go back to the 1960-1981 period we analyzed earlier in the letter, you will see that a Moderate risk allocation which included 20% in small companies and 40% in bonds suffered a 22% loss in the 1973-74 bear market. A Conservative risk allocation, using 60% in bonds, was down nearly 12%.

In the most recent bear market from 2000-2002, a Moderate risk allocation, which included an allocation to international equities, lost nearly 16%, while a Conservative allocation lost less than 2%. This was accomplished simply by including fixed income in the mix to varying degrees.

We go a step further with our portfolios by adding gold and real estate when indicated by our work, using relative strength on our sector work and core equity holdings and using our risk management models to determine exposure to the markets, with the underlying core belief that there are certain environments that are more favorable for investing in stocks, and others which are not.

Below are the three biggest draw downs in the S&P 500 Index of the past four years, along with the draw down which took place in TABR's Moderate Risk real-time account, which is managed exactly like client accounts:

<u>Time Period</u>	<u>S&P Draw down</u>	<u>TABR Draw down</u>
3-7-05 to 4-15-05	-6.74%	-4.40%
5-5-06 to 6-13-06	-7.69%	-4.98%
10-9-07 to 3-10-08	-18.64%	-3.75%

One might be wondering why the account lost less in the recent drop, which was more than two times as great as the declines in 2005 and 2006. Good question. All periods had about 39% in bonds, so that wasn't the answer. I feel it was a combination of things. In 2005 and 2006, we were maintaining 10% of the portfolio in gold. That was reduced to 5% in 2007, and a 5% allocation to sectors was created. The Hussman and Leuthold funds were not in the portfolio in 2005, and we were still in a bull market in 2005 and 2006, and assets behave differently in bull and bear markets, just as our models do.

Though we hope our future performance in difficult environments is similar to this recent one, we realize that each market cycle is a bit different. The main message we want to convey is that risk and reward go hand in hand in the financial markets, and in our opinion, it is important to minimize the downside because a majority of investors cannot handle what happens in normal down market cycles. I can't blame them—buying and HOPING the market will recover is not a very good investment strategy.

There is no denying that it is uncomfortable to watch the value of your portfolio go down. But, a certain amount of risk must be tolerated if one wants a return that will keep up with the rate of inflation. One must learn to deal calmly with market volatility, and I feel our risk management approach does just that. In a recent LA Times personal finance column, an investment advisor used a good analogy.

“You are on a long-term journey. If you are on a plane on a long journey, you are going to hit turbulence. If your response to that turbulence is land the plane and get out, you are never going to get where you want to go.”

Client Referrals/New Business

Periodically, clients ask us if we are accepting new business, and if we have any minimums (minimum account size). Here's our answer—yes, and sort of.

Currently, we serve about 260 households and manage \$158 million, with 25% of the households out of state. We've always struggled with the concept of account minimums, because since 1995, almost all of our growth has come from unsolicited referrals from existing clients.

I always remember where I came from, so frankly, I have a hard time telling a friend or family member of an existing client that we cannot serve them simply because they don't have \$500,000 to invest with us (that figure seems to be the norm today for many practices). On the other hand, Steve Medland and I realize there is a limit to the number of households we can effectively serve, without adding additional staff (maybe that comes later).

So for now, we've compromised in this fashion. If a referral comes our way from an existing client, there is no minimum, as long as its been determined by both sides we are a good fit. That also means, implicitly, they believe in our philosophy and will go through our entire process.

On the other side, we are actively marketing TABR's services through the FPA (Financial Planning Association), NAPFA (National Association of Personal Financial Advisers) and the Paladin Registry. In these forums, not only are we looking for a good fit, but we ARE looking at minimums of about \$300,000 and up. I hope that is helpful to all of you.

First Quarter Performance

Below is the performance, net of management fees, of six real-time portfolios we are tracking. These represent a majority of the strategies we are using in client accounts, but not all. The differences are mainly attributed to risk (example—moderate allocation versus conservative allocation or aggressive) and account size. The numbers are for the first three months of 2008, through March 31.

Type of Account/Strategy	YTD	Benchmark
TABR Moderate Risk Account	-2.48%	-4.74%*
TABR Stock Wrap Account	-7.39%	-9.50%**
TABR OEX Relative Strength	-9.65%	-10.01%(S&P 100)
TABR D.A.L.I. Account	-6.23%	-4.74%*
TABR Passive Allocation	-7.59%	-4.74%*
TABR Bond Account	-0.18%	+2.18%***
Vanguard Total Stock Index		- 9.50%
Vanguard Total International Stock Index		-8.90%
Vanguard Total Bond Index		+ 2.18%

*consists of 45% Vanguard Total Stock Index, 15% Vanguard Total International Stock Index and 40% Vanguard Total Bond Index

**Vanguard Total Stock Index

***Vanguard Total Bond Index

Returns shown are net of management fees, and include reinvested dividends

The approximate average invested exposure of our tactical equity allocations in the first quarter was 44%. As this is written in late May, that exposure was about 64%. The individual stock screens from Value Line, Zweig and Greenblatt continue to under perform versus our core mutual fund strategy, so as noted in last quarter's letter, we'll be evaluating it even more so at the end of 2008.

Summer is almost here. Great weather, and great times with family and friends. Enjoy it, and as always, thank you for your continued trust and confidence.

Best regards,



Bob Kargenian, CMT
President

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Comparison of the TABR Model Portfolios to the Vanguard Total Stock Index Fund, the Vanguard Total International Stock Fund and the Vanguard Total Bond Index Fund is for illustrative purposes only and the volatility of the indices used for comparison may be materially different from the volatility of the TABR Model Portfolios due to varying degrees of diversification and/or other factors.

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