HAMILTON POINT
Investment Advisors, LLC
CHAPEL HILL, NC • CLINTON, NY

ANDREW C. BURNS
President/Chief Investment Officer

RICHARD S. WOODS
Chief Operating Officer

JANUARY 2009

Don't Back Into the Future While Examining the Past

Too much conventional investment commentary is based on selective analysis of past markets and recessions. We remind readers that it was this use of "crystal balls made of rear-view mirrors" that led to some of today's least successful investment strategies. This issue of our newsletter will lay out our market view as America faces the consequences of decades of over-spending and over-borrowing in the face of an ever-growing global economy. While there are no guarantees, our analysis indicates that the coming years will likely be marked at home by recession, tax credits and deflation followed by slow growth, much higher taxes and, eventually, inflation.

RESPONDING TO A SLOW GROWTH WORLD

Over the last year, markets have torturously come to terms with stark adjustments to assumptions about future worldwide growth, savings and debt. Assuming, some would argue generously, that global GDP grows over the next five years at just 2% annually to $68.5 trillion — instead of previous predictions of near 6% annual growth to $82.5 trillion — means that Global GDP in 2013 will be nearly $15 trillion lower than recent projections had indicated. The global market certainly did not ignore these new estimates as witnessed by some $30 trillion in lost stock values since early 2008.

Investors have reacted to this outlook by selling securities and depositing the proceeds in short-term money markets, which now total nearly $4 trillion — up a trillion from last year. Consumers have reacted by exercising their right to discontinue frivolous spending, causing savings rates to jump substantially as consumers and businesses cut back. We expect this cash cushion to continue to grow as long as investors shun risk and seek haven in short-term money markets as they watch the recession unfold.

WHAT HAPPENS NEXT…THE GREAT STIMULUS

Amazingly, in a matter of months, America has left its free-market philosophy behind and is already well on the way to nationalizing a goodly portion of the banking and insurance industries. It continues forward with the Government checkbook wide open. Meanwhile, a much anticipated stimulus plan from the new administration is taking shape, which may well be followed by further bailouts of the automobile industry and State governments.

To many, massive stimulus seems a curious solution to our problems. This point was made well at a recent investment conference where an audience member asked a panel of economists:

> *"If you are correct in saying that what got us into this was too much spending and too much debt … how in the world will more of both be of any help?"*

The panelists had no real response. Similarly, the only debate nationally among economists and politicians seems to be about the size of the stimulus rather than the long-term consequences of such actions. Just the same, fiscal stimulus is what we are going to get and so we must prepare for the consequences.

FACING THE FISCAL CONUNDRUM

Our government's gross debt burden, which was nearly $9 trillion in late 2007, is now likely to increase by as much

as $5-$7 trillion by the end of 2011 — all while we struggle to grow GDP. It is difficult to accurately forecast inflation, chiefly because it is so highly dependent on future actions of the U.S. Government and the Federal Reserve — actions that remain impossible to predict. Nonetheless, there is little doubt in our minds that massive stimulus will eventually bring about strong inflationary pressures. This is a recurring problem for the Federal Reserve, but the conundrum this time lies in the fact that we no longer have the fiscal flexibility to withstand slower growth and sustained budget deficits. Taming inflationary pressures a few years out may choke off the economic growth needed to bring fiscal budgets in balance — a classic no-win situation.

Even if politicians agree on reductions in government spending, major tax reform (in this case, reform equals increase) must take place before long. Our best guess is that a tax on wealth for wealth's sake will be one idea. This is how real estate is taxed — based on its value. Who knows, maybe untaxed entities like universities will also be taxed on the size of their endowments. Current government data shows that the financial holdings of all households and non-profits still total around $45 trillion. A simple 1% tax would rake in $450 billion annually for a government very much in need. Any shortfall not met by taxes or government cuts may have to be assuaged with inflation.

THE GLOBAL PERSPECTIVE

This stimulus — which is simultaneously happening through coordinated efforts in countries across the globe — will play out differently throughout the world. Things could get downright dismal in Europe as countries confront many of the same banking and fiscal problems facing America. China will be negatively impacted by a decline in global trade, but still has huge surpluses to spend on much needed infrastructure. Because most Asian countries have similar flexibility, we expect they will be very good places to invest. We have optimism for Brazil as well — but not for Russia, where low oil prices and an insidious turn toward despotism has sapped its economic prospects for the time being.

POSITIONING PORTFOLIOS ACCORDINGLY

We are in a new world marked by government intervention, globalization and increased volatility. As developed countries restructure their economies, certain industries will likely continue to prosper, especially agriculture, consumer staples, productivity-enhancing technology and energy. Emerging economies will continue to grow, but surely at a slower rate than before. Other segments may contract substantially. Banks that survive effective nationalization will remain burdened by heavy regulation. Construction and consumer discretionary stocks will almost surely face prolonged headwinds as consumers continue to "right-size" their budgets.

In our view, the brutal drop in both stocks and non-Treasury bonds over the last year, has been sufficient, in many cases, relative to the new paradigm we envision — one where a globally-coordinated stimulus eventually works, trillions sitting on the investment sidelines return on a selective basis to stock markets and inflation becomes the new worry. Recall that the prospect of inflation is not inherently bad for stocks, particularly since the necessary precursor to inflation would be global growth and rising asset values — a huge positive for stocks. In fact, selected stocks will likely rise in a fast and furious manner well before renewed signs of growth are fully visible. The key impact of inflation will be felt over the longer-term through higher interest rates, lower values on existing long-dated bonds and diminished prospects for a broad and sustained, bull-market rally.

At Hamilton Point, we believe volatile and, at times, illiquid markets are here to stay, but prudent long-term investments will be rewarded. Accordingly, whether it's a barrel of oil, a share of stock or a bond, investors best have their own view of what something is worth and decide whether to ignore — or take advantage of — securities priced by the marginal trade. While we remain mindful of history, we will spend much more time examining the constantly evolving set of current circumstances to refine our investment outlook and position portfolios accordingly.

Andrew C. Burns
President/Chief Investment Officer

Hamilton Point Investment Advisors is an independent and independent-minded, boutique investment advisory firm. Please contact us for a complimentary review of your portfolio by calling (877) 636-3765. In addition, visitors to the firm's website, www.HamiltonPoint.com, can read past investment newsletters.

This newsletter contains general information that is not suitable for everyone and should not be construed as personalized investment advice. Past performance is no guarantee of future results. There is no guarantee that the views and opinions expressed in this newsletter will come to pass. Investing in the stock market involves gains and losses and may not be suitable for all investors. Information presented herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Hamilton Point Investment Advisors, LLC ("Hamilton Point") is an SEC registered investment adviser with its principal place of business in the State of North Carolina. Hamilton Point and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which Hamilton Point maintains clients. Hamilton Point may only transact business in those states in which it is notice filed or qualifies for an exemption or exclusion from notice filing requirements. This newsletter is limited to the dissemination of general information pertaining to its investment advisory services. Any subsequent, direct communication by Hamilton Point with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Hamilton Point, please contact Hamilton Point or refer to the Investment Adviser Public Disclosure website (www.adviserinfo.sec.gov). For additional information about Hamilton Point, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest.