

Murphy Capital Management

Year-End Review

January 2009

The year 2008 will go down as one of the worst performing years in stock market history. The rapid sequence of events were inconceivable just ten months ago. No one could have predicted that the government in a matter of weeks would be forced to take over Freddie Mac and Fannie Mae, bail out AIG and Bear Stearns and broker a merger between Bank of America and Merrill Lynch. In addition, the government provided capital injections to General Electric and Citigroup and watched the collapse of Lehman Brothers and numerous banks, brokerage firms and hedge funds. The lack of oversight and adequate risk controls, widespread corporate greed and deception by trusted financial institutions created panic, distrust and fear. This coupled with a complete meltdown in the automobile and housing industries as well as record high oil prices led many in the investment community to feel betrayed and demoralized.

Certainly the economy is on everyone's mind. The S&P 500 Index declined nearly 40% in 2008 and Asian and European markets were down sharply as well. The average investor has experienced a sharp decline in the value of their net worth. However, we would argue that the elements of a global recovery are being created as we write this letter. Governments around the world have injected massive amounts of liquidity into their respective economies, interest rates have been aggressively lowered to record levels, and there is tremendous deleveraging of banks, brokerage firms and individual consumers worldwide. As a result, energy prices have plummeted, the housing bubble pierced and stock prices are discounting marginal growth for next year. It's imperative to keep in mind that there is an estimated \$3.7 trillion dollars temporarily sitting in short-term government instruments waiting to be reinvested back into the market. Once this begins to occur, coupled with the massive liquidity injections, aggressive lowering of interest rates, and a comprehensive stimulus package, you can see why we continue to believe that a properly diversified stock portfolio represents sound long-term value at current levels.

We certainly are not conveying that the economy is out of the woods or that economic growth is right around the corner. Nor are we turning a blind eye to possible changes in tax legislation or the effects of high unemployment or even additional revelations about banks or corporate improprieties that may cause additional market unrest. However, as more and more negative news becomes priced into the market investors should be forward looking and establish sound core holdings in companies that will participate in the inevitable recovery. It's also important to keep in mind that the stock market is a leading indicator and is usually six months ahead of the economy. Therefore, it will begin to show signs of improvement well before the economic indicators begin to trend higher.

In the twenty years following 1931 (i.e. 1932-1951), the S&P 500 gained 11.7% per year on a total return basis. In the twenty years following the 4th quarter Stock Market Crash of 1987 (i.e. 1988-2007), the S&P 500 gained 11.8% per year on a total return basis (source BTN Research). If history is any indication we may be setting up the initial framework for a recovery that will lead the United States out of recession and into an eventual bull market.

We do remain cautious with the overall investment climate, but we continue to emphasize investing in companies with strong underlying financials, sound products, global market domination and pricing power. Our clients, while disappointed with the declines in their portfolios did not give into the irrational panic selling by locking in losses that could be eventual gains.

We know how difficult and emotional this past year has been for all investors. However, the only way to rebuild is through sound, patient and consistent investment decisions and through a dedication to staying the course in very difficult times. We want our clients to know that we have a strategy in place and that we are safeguarding assets as best we can in a very challenging environment while positioning portfolios to benefit from market strength and the subsequent recovery.

It is very easy in times like this to lose faith in the markets. When the multitude of talking heads beat the same drumbeat it can test one's resolve. Keep in mind that no one knows the true path of the stock market and when things look bleak the tide has a way of changing. Successful investing is not achieved by timing the market or by running for the exits when times get tough. Rather, it's the result of investing in high quality, diversified vehicles and making the tough decisions in challenging markets that enable returns to compound over a multi-year period of time.

Sincerely,

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President

Peter J. Lewis
Partner