HUDSON VALLEY
WEALTH MANAGEMENT

Q3 2008 Review

Through the third quarter of 2008, we have been witnesses to several historic, unprecedented events that have significantly damaged Wall Street, Main Street, and the United States economy. We have seen the collapse and/or insolvency of a number of iconic financial institutions, including Bear Stearns, Lehman Brothers, Merrill Lynch, AIG, and many, many others. We have also seen a virtual seizure of the global credit markets, a continued collapse in housing prices, and a barrage of government intervention. There's more than a little bit of fear in the markets, and, more importantly, in the minds of the individual investor today. Some of those fears are warranted, but some are irrational and detrimental to your long term goals. In response to those fears, I offer you an investing tidbit from a fairly well known investor:

> “We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.”
> - Warren Buffet

What is fear? Is it the uncertainty you feel about your future investment performance? Is it the apprehension that comes with watching stocks and bonds lose a portion of their value over the course of a month, quarter, or year? Is it the thought that you might not reach your savings goals? All of those are valid concerns. That said, it's important to put recent events into a historical context so that we can manage our “fears” and properly manage our expectations and decision making processes going forward.

At Hudson Valley Wealth Management, we view fear as an opportunity. We view fear as the chance to act against conventional wisdom, and to get rewarded over the long term to do so. We view fear the way Warren Buffet views fear – as a time to be greedy.

How do stock markets measure fear?

In stock and bond markets, there is an index known as the “VIX”, which measures volatility in the markets. It's affectionately known as “The Fear Index” among Wall Street professionals. Without getting too technical about how it works, I want you to understand the idea. The “VIX” measures volatility in the markets, and is widely used as an indicator of the “mood” of the investing public. A measure of the index below 20 is considered a “bearish” sign – meaning that there is very little fear in the markets – complacency, if you will. That makes sense, if you think about it. When things are going well, and markets are consistently going up, there is very little fear or apprehension in the market. If that's the case, traders argue that it's time to sell – or “be fearful when others are greedy” as Mr. Buffet says. Conversely, when the “VIX” is at or above 30, it is believed that there is “too much fear” in the market, and traders view that as a good time to buy – or time to “be greedy when others are fearful.” Where is the “VIX” today? 52.

Acting on Fear = BAD DECISIONS

At Hudson Valley Wealth Management, we've long talked about our "Behavioral Finance" interests – that is how the feelings and emotions we have as people often can adversely affect the investment decisions we make. For example, most individuals tend to want to invest more money in the stock markets when "things are good" in the market, or when stocks are going up. Conversely, when "things are bad" and stocks are going down, people have a tendency to not only shy away from investing in the market, but may consider pulling their money out all together. If you think about that rationale, it's completely counterintuitive. Think about this – if you pulled up to your favorite store and saw a sign outside that read ***"Everything in the store today – 25% MORE!"*** would you go in and buy anything? Of course you wouldn't. Interestingly, that's exactly what individual investors tend to do with their investments – they buy when things are more expensive and sell when things are cheap. By letting your emotions control your investment decisions, you cripple yourself as an investor, and make it nearly impossible to achieve consistent returns over time. Let's take a look at the last 2 weeks in the Dow Jones Industrial Average as an example:

Date	Open	Close	Change
30-Sep-08	10371.58	10850.66	479.08
29-Sep-08	11139.62	10365.45	-774.17
26-Sep-08	11,019.04	11,143.13	124.09
25-Sep-08	10,827.17	11,022.06	194.89
24-Sep-08	10,850.02	10,825.17	-24.85
23-Sep-08	11,015.69	10,854.17	-161.52
22-Sep-08	11,394.42	11,015.69	-378.73
19-Sep-08	11,027.51	11,388.44	360.93
18-Sep-08	10,609.01	11,019.69	410.68
17-Sep-08	11,056.58	10,609.66	-446.92
16-Sep-08	10,905.62	11,059.02	153.40
15-Sep-08	11,416.37	10,917.51	-498.86

If you look at the incredible volatility over the past 2 weeks or so, you can see the point illustrated perfectly. If you saw the Dow Jones on 9/15 fall 498 points and decided to pull your money out of the market, you immediately missed the 153 point gain the following day. If you saw the market down 446 points on 9/17 and pulled your money out, you immediately missed out on the next two days' 772 points worth of gains! And if the historic fall of more than 770 points scared you away on the 29th, well then you would have missed the nearly 500 point recovery the next day. On the flip side, if you bought stocks on any of those large down days, you would have made money the next day nearly every single time. Staying invested through volatility, and adding to investment positions during large down days, remain the best ways to preserve invested capital and grow your money.

Is my money safe?

One of the most frequent questions I hear asked is "Is my money safe in the bank?" With all of the recent turmoil in the banking system, it's reasonable to assume that your money may be at risk. I want to take a second to explain that your money is safe – to a point. If you hold money (cash) in a bank checking or savings account, those deposits are insured by the FDIC up to $250,000 per account holder. That's per person, not per account. If your cash is in a money market investment fund, the Federal Government has recently agreed to insure those deposits as well – up to a limit of $1,000,000 per account. It's a temporary insurance, but insurance nonetheless.

How is my investment account performing?

The short answer is this – most all of the diversified investment accounts we manage for our clients have done considerably better than the major indices through this prolonged period of volatility and market weakness. Though account balances are lower than they were at the beginning of the year, we haven't seen draw downs to the extent that the major indices have pulled back. There are a number of reasons for our outperformance:

1. Diversification – by not "putting all of our eggs in one basket", we have been able to mitigate some of the negative returns produced by the broad equity markets. Our equity allocations are very well diversified across most major equity asset classes – domestic stocks, international stocks, intermediate term and government bonds, real estate, and commodities.
2. Very Low Expenses – by investing in low cost investment vehicles like ETFs and Index Funds, we have minimized the expenses that our clients incur. Unlike mutual funds that can charge 1.75% or more a year, our average portfolio has an internal expense ratio of only about .4%. Those low expenses help keep more money in our clients' portfolios, and help keep more of their dollars working for them.
3. TIPS – TIPS, or "Treasury Inflation Protected Securities" are a portion of most all of our clients' portfolios. These investments are Government bonds whose interest payments increase as inflation does. In times like these, with a weakening dollar and increasing inflation, TIPS provide a dual purpose: preserving capital and providing increased interest earnings.
4. Commodities – although commodities and commodity equities have pulled back of late, they have still provided one of the few positive investment themes in 2008. As inflation increases, these commodity investments should continue to deliver good performance into the future, and are an essential component of our allocations going forward.
5. Real Estate – in most of our diversified client portfolios we have an allocation to both domestic and global real estate. Along with providing income, these allocations are well positioned to take advantage of the potential rebound in the real estate markets. These allocations are mainly commercial real estate investments, not investments in mortgage backed securities or residential homes.

Summary

We understand that these are extraordinary times in the world, and we know that you have a lot of uncertainty about the future. Let me assure you that this too will pass. The markets may not hit a bottom today or tomorrow, but eventually we will reach a point where the markets will flatten out and begin the recovery process. I cannot express the importance of staying the course in times like these – typically when "bear markets" like these end, they recover very, very quickly. Taking a historical look at past "bear markets", it important to note that once they have "hit bottom", ***the markets have recovered, on average, 33% of their losses within 40 days of the bottom.*** Assuming about a 30% downturn so far in the domestic markets, history suggests a 10% recovery in the month or so following the bottom of this current "bear market". That's certainly not a move that I want to see any of our clients miss by being on the sidelines.

I thank you for choosing Hudson Valley Wealth Management as your financial partner, and I assure you that we are continuously monitoring the markets and your investments. We are more than capable of managing our way through these volatile times. As always, if you have any questions or concerns, please do not hesitate to call us. We greatly value our relationship with our clients, and pride ourselves in making ourselves available to answer any questions you or your friends and family may have.