Commentary

In 2009, we face a very challenging investment climate. As we mentioned in our last letter, Rittmann Capital Management still feels that this is a once in a lifetime opportunity to buy companies at historically low valuations. So we must be patient, and the market will reveal itself.

In the span of the past six months, we have witnessed a historic collapse in the financial markets. No sector was left untouched, and the Wall Street landscape has changed irrevocably. Wall Street places paramount importance on clarity and transparency in the markets, yet in no other time since the Great Depression has the economy been so uncertain. Government intervention in the financial markets to date has exceeded levels previously believed likely or even possible. Not since World War II has the Government put this much monetary stimulus into our economy, and even this does not take into account the new administration's planned economic recovery plan.

During 2008, there was constant discussion of recession -- if, whether, when, and to what extent the United States was in a recessionary period. History has taught us that, when we finally realize we are in a recession, we have been in one for some time. Economists generally now identify December 2007 as the starting point, but the start date is to some extent meaningless. What is important is that we are in a very fragile situation. The economy is stretched very thin. Thus far, the bailout costs have been very high in terms of the government intervention, and the consequences are still unknown.

An undercurrent in the situation is that the credit markets are still somewhat frozen. Banks that are receiving money from the government bailout are keeping the cash in-house to bolster their balance sheets, instead of lending out the funds in new loans. The banks' main worry appears to be that, if the money is lent out, then the value of the underlying asset associated with the loan might decline. In a sense, the banks fear a repeat of what caused the whole mess in the first place, chasing after an asset class characterized by dropping values.

The level of severity of the economic crisis has brought forth a mutual cooperation between the outgoing Bush Administration and the incoming Obama Administration. This has been a pleasant surprise. However, officials within the new administration have stated that they plan changes in both the scope and the terms of the bailout.

There are a few key factors we need to understand to determine how and when we will emerge from this current crisis. What are the underlying effects of the bailout? Is there a continued deterioration of credit? When will the banks start lending? How will the size and scope of the proposed stimulation program from the new administration affect the economy? And, lastly, what type of visibility will be available to guide corporate earnings over the next few quarters?

At present, there are encouraging signs of healing as mortgage rates decline, saving rates increase, and 92 percent of Americans continue to be employed. Commodity prices have fallen dramatically, and oil, arguably once the main culprit behind inflation, has similarly seen large reductions in price. Some economic indicators show signs of improvement, although it is unclear how much of this might be the result of massive amounts of fiscal stimulus and Fed rescue efforts. It is likely that corporate earnings will slow, but such expectations are likely also already priced into the market.

In this dark cloud, there is a silver lining. As I mentioned above, this is definitely a difficult investing climate. However, we still believe in the companies in which we have invested and the strategic themes around which we have constructed our portfolios. Although we have of course been presented with a setback, our investment thesis remains intact, and companies will come out of this period leaner and more competitive. We do think that commodity prices, especially those of oil, will rebound significantly in the next year. Technology companies have always benefitted as industries as a whole attempt to be more productive and competitive in the global markets. Biotechnology and healthcare issues should receive a lot of attention as investors look to new areas seeking growth. We are also looking at companies that are potential beneficiaries of the government stimulus programs.

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