SIGMA
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Auntie Em, It's a Twister!

In our complex world, filled with "experts" babbling abstruse jargon, we can find true wisdom in stories we learn as children. For example, at the start of *The Wizard of Oz,* a tornado carries away Dorothy Gale's farmhouse with her inside. Such is the power of this tale that we need go no further to apply two key lessons to mistakes made in the recent crisis in the financial markets.

When Dorothy arrived back at the farmhouse as the tornado hit, she was alone; her relatives and the farm workers previously had retired to the storm cellar. There is lesson number one – those intelligent Kansans knew to prepare for a tornado. The number of severe tornadoes is small each year, and the chances of one striking your house are infinitesimal, even if you live in Tornado Alley. It is wise, however, to plan what you will do and where you will go if the tornado, however unlikely, threatens.

Severe crises in the financial markets similarly are rare but inevitable. The paradox is that the longer the period without trouble, the more reckless investors become, increasing the severity of the damage when the inevitable crisis occurs. Stability thus sows the seeds of unpreparedness and instability. Many investors concluded two years ago that there was no need for the market version of a storm cellar and mocked those who were cautious.

Two years ago, investors as a group demanded little additional expected return for assuming additional risk. Their rationales were many and varied. Some posited that the world economy had entered a "great moderation," in which business and market cycles were much less volatile. Others spoke of China and the emerging markets being "decoupled" from the economies of the United States and developed nations, insulated from their recessions. Investors thought new derivative securities offset their risk, protecting them from market volatility. This new breed of investor has now learned that, as infrequent as market storms may be, it only takes one if you were insufficiently prepared. In our home of Portland, Oregon the necessity of wearing snow boots, to use the statistical parlance of hedge fund managers, is a "three sigma event." This winter, though, many still wound up with cold, wet feet.

Back to Kansas, the second key lesson from Dorothy's journey to Oz was that she was not surprised when she landed. Yes, she saw the house and the cow and Ms. Gulch on the bicycle flying through the air, but, grounded in solid, Midwestern values and common sense, she did not conclude that the law of gravity had been repealed. Cows and cars flying through the air happen on occasion, but that is quite irregular. Soon, everything is again earthbound. If only investors as a group had Dorothy's equanimity.

> 2008 Market Summary:
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> ***"The wind began to switch; the house, to pitch; and suddenly the hinges started to unhitch."***
>
> – Dorothy Gale

In October and November, financial market storms sent quite a few normally earthbound investments flying through the air. Pundits billed market troubles merely as the consequence of a few dodgy mortgages, and yet the market savaged the prices of investment grade corporate bonds, municipal bonds, and blue chip stocks. Panic is contagious, tending to affect all assets. In a panic, normally uncorrelated securities start moving in lockstep and, in the recent trouble, even money funds came under a cloud. However, all that trouble was the result of the storm – the very infrequent storm. *Time* magazine does not normally have a 1930s soup kitchen line on its cover. People do not normally expect high quality corporations to disappear overnight. What if Dorothy's family had assumed that the permanent forecast was for constant tornadoes? They would get neither the crops planted nor the pigs fed, and they soon would run into problems unrelated to the weather.

Neither ignoring danger nor overestimating it is the proper course. Storms happen, both in Kansas and in the financial markets – if a storm hasn't shown up for a long time, well, that just means that one is overdue. The key is to be able to weather the storms, even the severe ones, and yet not be crippled in our ability to function in the world that is "normal," give or take, almost all the time. Pay no attention to the great Professor Bernanke behind the curtain; like Professor Marvel, he never guesses, he knows.

The enclosed sheet lists the returns from four major asset classes: large stocks, small stocks, foreign stocks and bonds, with a box around the best performer each of the past 43 years. This is index data, with no effect from timing, security selection, costs or taxes. On the right are aggressive and balanced diversified portfolios mixing the assets. Investing in either of the diversified portfolios has had a better long-run return than the S&P 500 index with less risk. Last year was the worst year for large U.S. stocks since 1931, the descent into the Great Depression, a period as bleak as Dorothy's Kansas. Two other declines in the U.S. market shown on the enclosed sheet, for 1973-74 and 2000-02, were about the same magnitude as what we experienced in 2008. The economy and markets recovered from all three of those earlier storms, and we will recover from this one – maybe not as fast as we would like or hope, but a recovery nonetheless. Eventually, the travails and upset of 2008 will be a distant memory.

What have you learned, Dorothy? Sudden, terrifying financial storms tend to follow extended periods of placid, benign market weather. The key to successful investing remains diversifying your portfolio and constructing a rational investment plan. Like everyone else, we are afraid of the flying monkeys, but we have the knowledge and discipline to help – contact us at (503) 419-3938 or www.sigmainvestment.com.

Single Investment vs. Multi-Investment Portfolios

Example: In 1967, small stocks were the best performer

	Single Investment Portfolios				Multi-Investment	
Year	Large U.S. Stocks	Small U.S. Stocks	International Stocks	Int-Term Gov. Bonds	Aggressive Mix	Balanced Mix
1966	-10.06%	-7.01%	-4.00%	**4.69%**	-6.46%	-2.95%
1967	23.98%	**83.57%**	15.70%	1.01%	31.53%	19.51%
1968	11.06%	**35.97%**	31.70%	4.54%	20.55%	14.04%
1969	-8.50%	-25.05%	**6.80%**	-0.74%	-7.21%	-4.76%
1970	4.01%	-17.43%	-10.51%	**16.86%**	-2.62%	4.83%
1971	14.31%	16.50%	**31.21%**	8.72%	18.41%	14.83%
1972	18.98%	4.43%	**37.60%**	5.16%	19.34%	14.79%
1973	-14.66%	-30.90%	-14.17%	**3.35%**	-15.98%	-9.01%
1974	-26.47%	-19.95%	-22.15%	**7.04%**	-20.74%	-11.77%
1975	37.20%	**52.82%**	37.10%	8.33%	37.41%	27.20%
1976	23.64%	**57.38%**	2.54%	11.74%	23.92%	19.09%
1977	-7.44%	**25.38%**	18.06%	3.01%	6.54%	3.85%
1978	6.40%	23.46%	**32.62%**	2.24%	15.95%	10.38%
1979	18.61%	**43.07%**	4.75%	6.59%	18.84%	14.17%
1980	32.50%	**38.60%**	22.58%	6.65%	28.66%	21.28%
1981	-4.92%	2.03%	-2.28%	**10.79%**	-1.30%	2.46%
1982	21.55%	24.95%	-1.86%	**25.42%**	16.76%	19.93%
1983	22.56%	**29.13%**	23.69%	8.22%	22.72%	17.65%
1984	6.27%	-7.30%	7.38%	**14.29%**	4.64%	8.29%
1985	31.73%	31.05%	**56.16%**	18.00%	36.33%	29.83%
1986	18.67%	5.68%	**69.44%**	13.06%	28.20%	22.74%
1987	5.25%	-8.80%	**24.63%**	3.61%	7.12%	6.10%
1988	16.61%	25.02%	**28.27%**	6.40%	20.19%	15.12%
1989	**31.69%**	16.26%	10.54%	12.68%	21.42%	19.37%
1990	-3.10%	-19.48%	-23.45%	**9.56%**	-10.20%	-2.73%
1991	30.47%	**46.04%**	12.13%	14.11%	27.36%	22.73%
1992	7.62%	**18.41%**	-12.17%	6.93%	4.76%	5.45%
1993	10.08%	18.88%	**32.56%**	8.17%	17.27%	13.57%
1994	1.32%	-1.82%	**7.78%**	-1.75%	2.00%	0.75%
1995	**37.58%**	28.45%	11.21%	14.41%	26.84%	23.44%
1996	**22.96%**	16.49%	6.05%	4.06%	15.55%	12.22%
1997	**33.36%**	22.36%	1.78%	7.72%	20.70%	17.27%
1998	**28.58%**	-2.55%	20.00%	8.49%	18.20%	16.14%
1999	21.04%	21.26%	**26.97%**	0.49%	20.51%	13.73%
2000	-9.10%	-3.02%	-14.17%	**10.47%**	-7.19%	-1.42%
2001	-11.89%	2.49%	-21.44%	**8.42%**	-9.37%	-3.76%
2002	-22.10%	-20.48%	-15.94%	**9.64%**	-17.06%	-8.32%
2003	28.68%	**47.25%**	38.59%	2.29%	32.23%	21.47%
2004	10.88%	18.33%	**20.25%**	2.33%	13.86%	9.61%
2005	4.91%	4.55%	**13.54%**	1.68%	6.67%	4.88%
2006	15.79%	18.37%	**26.34%**	3.84%	17.75%	12.85%
2007	5.49%	-1.57%	**11.17%**	8.47%	5.80%	6.83%
2008	-37.00%	-33.79%	-43.38%	**10.43%**	-33.21%	-18.66%
Return	**8.86%**	**10.67%**	**9.40%**	**7.58%**	**9.78%**	**9.26%**
Risk	**17.97%**	**25.34%**	**22.35%**	**5.43%**	**16.48%**	**11.18%**

Please read the footnotes and disclosures included with this report.

Current year data source: Morningstar Principia™ Mutual Funds Advanced, January, 2009. Data as of December 31, 2008[1]. Large U.S. Stocks: Standard & Poors 500 Stock Index; Small U.S. Stocks: Ibbotson & Associates, 1966 - 1978, Russell 2000® Small Stock Index 1979 - 2008; International Stocks: Europe, Australia, Far East Stock Market Index (EAFE International Index), John L. Maginn & Donald L. Tuttle, *Managing Investment Portfolios* 1966 - 1969, MSCI EAFE® (Europe, Australasia, Far East) Index[2] 1970 - 2008; Intermediate-Term Government Bonds: Ibbotson & Associates 1966 - 1972, Barclays Capital Intermediate Government Bond Index[3] 1973 - 2008 . The multi-investment alternatives represent the following mixes: Aggressive Mix: 45% Large U.S. Stocks, 20% Small U.S. Stocks, 25% International Stocks, and 10% Intermediate-Term Government Bonds; Balanced Mix: 35% Large U.S. Stocks, 10% Small U.S. Stocks, 15% International Stocks, and 40% Intermediate-Term Government Bonds. The representative Aggressive and Balanced mixes were rebalanced annually. Returns are compound annualized returns from 1966 through 2008. Risk is measured by the annualized standard deviation. Although data are gathered from reliable sources, Sigma Investment Management Company cannot guarantee completeness or accuracy. The numbers shown are for general market indices and do not reflect the composition or performance of Sigma portfolios or any recommendation of Sigma, nor do they take into account expenses, taxes or inflation. Past performance does not guarantee future results.

[1] Data for all prior periods was revised as of December 31, 2008, using L. Maginn & Donald Tuttle, *Managing Investment Portfolios,* the Ibbotson® SBBI® 2008 Classic Yearbook, Mellon (formerly Russell) Performance Universe and Morningstar Principia™ Mutual Funds Advanced, January, 1997 and January, 2009. The revised data resulted in a change to the overall annualized **Return** and **Risk** deviation of no more than 4 and 2 basis points, respectively, for any portfolio compared to data presented in prior-year tables. The updates did not affect single investment "best performer" status for any previous year.

[2] MSCI, Inc., formerly Morgan Stanley Capital International/Barra.

[3] On November 3, 2008, Barclays Capital announced the rebranding of its unified family of indices under the Barclays Capital Indices name. The rebranding changes the name of the index from "Lehman Brothers" to "Barclays Capital".