# VIEW FROM VISTA

October 7, 2008

Dear Valued Client,

Enclosed is your Quarterly Report from Vista Capital Partners for the 3rd quarter of 2008. Recent market events have led our clients to frequently ask two questions; "I know markets go up and down, but is it *different* this time?" and "Do we still have the right strategy and portfolio in place?" We would like to answer both of these important questions.

There is no doubt today's news is bad and many of the names, places and events are different from previous bear markets. Years of excessive borrowing, both by individuals and financial institutions, have led to an economically painful period of deleveraging. Years of price appreciation and speculation in the housing market have resulted in a sharp downturn in home prices. Warren Buffet is calling this combination an "economic Pearl Harbor." U.S. stocks are down 25%-30% from their peak in October 2007 and international stocks are down over 35%. This decline in U.S. markets has erased 10 years worth of gains.

What is not different are the economic forces of capitalism working to bring the financial markets back to a healthy equilibrium. What is not different is the 25%-35% drop in stock prices. U.S. stocks have dropped over 15% a dozen times in the last 50 years. By comparison, the current decline does not stand out for its magnitude or duration. This downturn is certainly stressful, yet unremarkable from a historical perspective. What is not different are the headlines and panic in the media that call into question the wisdom of investing in stocks. Every bear market is filled with stories of doom and gloom that frighten investors and drive them to the sidelines. Investors pulled record amounts out of stock funds in 2002 – right as the market was set to almost double over the next five years. And what is not different is that those investors who remain patient and disciplined will inevitably be rewarded for doing so. The 12 bear markets since World War II have been followed by 12 bull markets lasting an average of 45 months during which time the S&P 500 gained an average of 124%.

Will the news get worse? Quite possibly. Will stock prices go lower? Maybe. Will it eventually feel safe to invest in stocks again? Absolutely. Of course, the Dow Jones Industrial Average will likely be up 20% or more by then. Looking back at the last dozen bear markets, investors holding stocks at the bottom made an average of 33% over the next 12 months. If an investor instead waited for just a small sign that the turnaround was underway, and bought stocks just three months after the bottom, the average gain dropped to just 15%. The message? Don't time the market. It is an endeavor fraught with peril. Remember, stock prices typically lead the economy by 6-12 months. So today's prices already reflect the bad news we expect to be reading over the coming year. By the time we begin reading about a turnaround, the next bull market will have largely passed us by.

While we do not know when the next turnaround will begin, we are encouraged by the fact the Dow Jones is trading at only 12 times earnings forecasts for the coming year. The long-term average P/E for stocks is around 15. At today's low prices, the future return potential of a diversified stock portfolio looks better than it has in years.

Real estate problems, government bailouts, bank failures, global financial meltdowns, and gyrating commodity prices are only some of today's problems. Do these events call into question Vista's investment strategy? No. In fact, we believe the opposite to be true. If anything, recent events prove the wisdom of owning a globally diversified portfolio that eliminates unnecessary risks, costs, and taxes.

While we continue to have great conviction in our investment philosophy, this does not mean we are standing idly by as the market fluctuates. We are constantly monitoring portfolios for the opportunity to rebalance—selling bonds at today's high prices and buying stocks at today's low prices. This disciplined process, triggered when an asset class exceeds its target by more than 20%, is a proven and repeatable way to control risk and increase returns. We have also used the drop in stock prices to make beneficial changes to portfolios we have previously been unable to make for tax reasons. An example of this is selling one index fund to buy another that tracks a similar or superior index at a lower cost—booking a loss for tax purposes at the same time. There are additional tax-loss selling strategies we will be looking to execute to decrease your tax bill.

A diversified stock and bond portfolio is not a money maker in a bear market. However, it ensures participation in the eventual market rebound and provides returns superior to most alternatives. Throughout history, investing in stocks (owning companies) has allowed investors to benefit from the growth and prosperity of the world's capital markets. While far from perfect, capitalism has proven to be incredibly resilient. Our markets have survived World Wars, world plagues and worldwide financial meltdowns. They adjust to new events and circumstances and forge ahead. New opportunities emerge for investors to take advantage of global innovation, technology and the powerful forces inherent in our collective effort to build a better life. We are confident this time will be no different.

*Investment Focus*

Vista favors index funds which make no attempt to identify attractive securities or time the market. A commonly heard criticism of index funds is, "When the market goes down, index funds go down right along with it." This viewpoint is often accompanied by the assertion that skilled "active" investors can anticipate bear markets, and take precautionary actions to prevent losses in a market downturn. The hope is that through superior stock-picking (e.g., favoring larger, defensive companies in a recession), holding more cash, market timing (buying on dips, selling on tops) or selling stocks short (to profit from price declines) active managers can "outperform" index funds in down markets. This sounds attractive enough, but does it actually occur? Do active managers shine in down markets?

In 2001, Schwab's Center for Investment Research looked at this very issue. In a white paper entitled, **"Index or Actively Managed Equity Funds: Which way to go in a down market?"**, researchers

compared the performance record of 120 index funds and 2,100 actively-managed mutual funds. After analyzing these funds' performance during market declines occurring from December 1986-March 2001, the researchers concluded:

- Index funds outperformed actively managed funds in 55% of the down markets**.**
- In the worst downturns, defined as declines of 10% or more, index funds outperformed actively managed funds 75% of the time.
- In the longest downturns, defined as declines of 5 consecutive months or longer, index funds outperformed actively managed funds 100% of the time.

More recently, according to mutual fund database Morningstar, in the twelve months ended September 30th, 2008:

- The S&P 500 Index outperformed 61% of large cap stock funds.
- The S&P Midcap 400 Index outperformed almost 90% of all actively managed midcap stock funds.
- Among small cap funds, fewer than one in five managed to beat the Russell 2000 Index.

The implication of this data is clear: Index funds minimize the risk of having an actively-managed fund turn a bad year into a horrible one. While it might sound logical and alluring to employ an active manager to "do something" in the face of uncertain markets, the evidence resoundingly supports the efficacy of an index fund approach. Whether in good or bad markets, passively-managed index funds remain a key ingredient of the diversified portfolios we have constructed to earn our clients a lifetime of investment success.

*Wealth Management*

With the recent news coverage of failed financial institutions, a question on everyone's mind is, "How safe is my cash?" In the aftermath of the bank failures that led to the Great Depression, the government created the FDIC (Federal Deposit Insurance Corporation) to insure bank deposits up to $100,000 per depositor per bank. Recent legislation has temporarily increased the limit to $250,000. Backed by the full faith and credit of the U.S. government, no depositor has ever lost a single penny of insured deposits.

Need to insure more than the stated limit in cash? Investors can access up to $50 million of FDIC insurance through a single bank via CDARS (Certificate of Deposit Account Registry Service). When a large deposit is made with a network member, that institution uses CDARS to place the funds into certificates of deposit issued by other banks in the network. This occurs in increments of less than the stated limit to ensure that both principal and interest are eligible for full FDIC insurance. To locate a member bank, visit **www.CDARS.com**.

As for the safety of assets held in investment accounts, the SIPC (Securities Investor Protection Corporation) will restore up to $500,000 in assets per account held at bankrupt and otherwise financially troubled brokerage firms. In addition, the custodians Vista has partnered with—Charles Schwab and TD Ameritrade—provide an additional **$150 million** in investor protection through Lloyd's of London.

*Other*

We have some news we are proud to share with you. Schwab Institutional, the leading provider of custodial services to investment advisors and their clients, recently announced the winners of the third annual IMPACT Awards—an industry-wide awards program to honor advisors that have advanced the industry through their visionary leadership, operational excellence, technology innovation and growth. Vista Capital Partners was awarded Schwab's Pacesetter IMPACT Award. The award is given to an up-and-coming firm in business for less than 10 years that most exemplifies these qualities.

Vista was selected to receive the award by a distinguished panel of judges that included the Executive Directors of the Investment Advisors Association, the Investment Management Consultant Association and the Financial Planning Association. On behalf of our firm, Schwab donated $5,000 each to the Children's Cancer Association and the Leukemia & Lymphoma Society.

While we hesitated to share the news of this award in the midst of such trying times, we ultimately decided it may be exactly the right time to let you know you are being advised by a firm considered to be one of the very best.

As always, we welcome your calls and e-mails and look forward to our next meeting or conversation. Thank you for being a client.

Sincerely,

Vista Capital Partners