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# Investment Directions

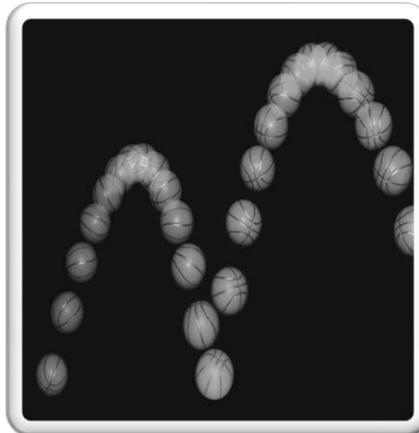
Spring 2010

## Flash Crash

On May 6<sup>th</sup> we experienced what some in the press are calling a “flash crash.” On that day, the Dow Jones Industrial Average<sup>1</sup> fell dramatically then rebounded dramatically in the space of about half an hour.

The day began quite normal, trading a bit lower until about 2:00 pm Eastern time. Then, in the two o’clock hour, the Dow suddenly dropped nearly 1,000 points then almost as quickly regained 650 of them. By 4:00 pm, when trading ended, the Dow had lost 347 points or about 3% of its value. It was an unprecedented fall and rebound.

As I write this, regulators and trading officials are still trying to figure out what caused the dramatic dip. One thing is clear, however: when prices dropped, buyers appeared.



## Bubbles Vs Rebounds

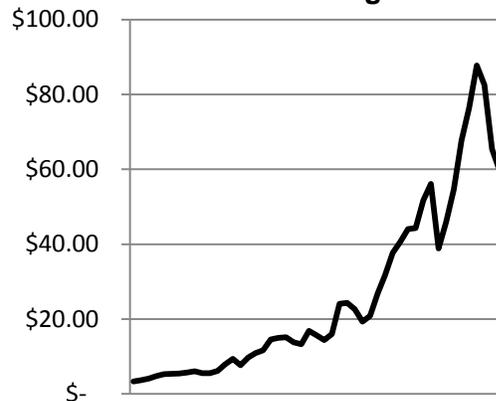
Early last year when prices were dropping, buyers were slower to return. When they did, prices moved up quite far and quite fast, prompting some to ask is this a rebound or a new bubble?

A rebound implies investors are comfortable with current prices; a bubble indicates investors are more worried. In my

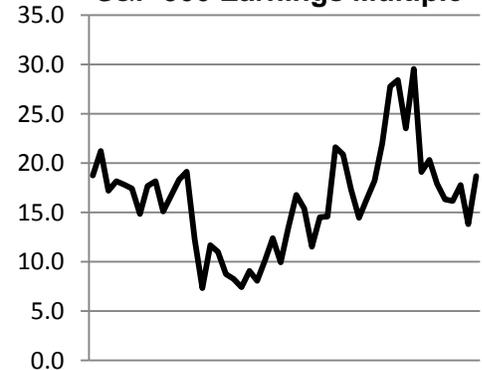
opinion the quick return of buyers seems to favor rebound.

Another way to assess the bubble vs rebound question is to look at corporate earnings and how much investors are willing to pay for them. The charts below<sup>2</sup> illustrate 50 years of history on those two points and to my eye neither appears to be approaching an historical high point. All of this leads me to believe we may still be in rebound mode. I expect continued volatility but I don’t believe this is a bubble about to pop.

S&P 500 Earnings



S&P 500 Earnings Multiple



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<sup>1</sup> The Dow Jones Industrial Average is an index of 30 large American Companies, you cannot invest directly in an index.

<sup>2</sup> Charts represent the S&P 500 stock index from 1960-2009. Source: Standard and Poors. Past performance does not guarantee future results. Earnings multiple is obtained by dividing Index value by index earnings.



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*"Live as if you were to die  
tomorrow.  
Learn as if you were to  
live forever."  
- Gandhi*

*"We cannot hold a torch  
to light another's path  
without brightening  
our own."  
- Ben Sweetland*

*"The most effective way to  
remember your  
wife's birthday is  
to forget it once."  
- H.V. Prochnow*

*"Chance favors  
the prepared mind."  
- Louis Pasteur*

*"Most people are about as  
happy as they make up  
their minds to be."  
- Abraham Lincoln*



LET'S TALK ABOUT...

## BEING PREPARED

I am a big supporter of the Boy Scouts. I have three sons who are Eagle Scouts and a fourth who is working on it. The Boy Scout motto is "Be Prepared."

When we choose to be prepared we choose to be responsible. We all have responsibilities to our loved ones; one of the great challenges of shouldering that responsibility is anticipating and preparing for the surprises of life.

Fortunately there are things we can each do to prepare in advance. Here is a checklist of steps we can all take to help our families should unexpected events arise:



- ❑ **Make a "Legal Documents" file.** In that file keep critical personal, business and financial information. Your will should be in there for example (as long as you have it out you might review it to make sure it says what you want it to say). Other documents might include powers of attorney, directive to physicians and contact information for your tax, legal and investment advisors.
- ❑ **Select a single location for statements, checks and other records... then show your family where it is.** Simplicity is the key here whether it is a file drawer or a cardboard box, have a single place where statements are filed as they arrive. In most families one person handles writing checks, paying bills and balancing statements. Make sure others know how

to do those things in case they need to take over in a time of crisis.

- ❑ **Make a file of important family history documents.** Include birth certificates, marriage certificates, labeled family photos, etc. You might keep newspaper clippings, genealogy or a brief personal history there too. My wife makes scrapbooks and in our family we have a saying: *"If it isn't in the scrapbook, it didn't happen."*
- ❑ **Make a list of assets and stuff.** Start by listing current assets and account numbers and include how the ownership reads: individual, joint ownership, etc. The list should also include benefits due a spouse or beneficiary from retirement plans, life insurance policies and social security estimated benefits. If you put your list in a file, you

might keep titles for your vehicles and real estate there too.

- ❑ **Make a list of debts and obligations.** This would include mortgage, auto, credit card and other loans. The name on the loan or account and the account number, payment and ending date should be listed. Auto leases, cell phone contracts and other obligations should also be noted.
- ❑ **Provide a backup person access to safes or safe deposit boxes.** If you use a safe deposit box make sure it is in more than one name, otherwise it may not be immediately accessible when needed. If you use a safe, make sure you have another person or two who would know how to open it in an emergency.
- ❑ **Identify a friend or family member who can help out in a crisis.** Talk with that person in advance and tell them what you are thinking, explain what you hope they might do and ask them if they would be willing to help if needed. Keep a current address and telephone number for that person in a place that would be easy for others to find. Having someone to lean on in a time of need can provide tremendous strength and comfort.



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## New Tools for New Times

### The Confidence of a Pitching Coach

Rick Adair is the Seattle Mariners' pitching coach. If his guys throw pitches the other team can't hit, the Mariners usually win.

Unfortunately, in the course of a game, they sometimes hit batters, make mistakes and throw pitches that get hit out of the park. You might wonder, how can Coach Adair live with himself?

Having never been a professional pitching coach I suspect it has to do with hiring quality pitchers, making adjustments mid-game and a big bottle of Pepto Bismol.

Being a successful pitching coach is a lot like being a successful investor. Much of your success may depend on setting realistic expectations and accepting that there are things outside your control.

### Investing Like A Good Pitching Coach

Professional pitching coaches have confidence in their pitchers that is not shattered if one of their pitchers throws a bad pitch; they expect quality pitchers to throw more good pitches than bad ones.

Life, like baseball, is full of surprises. Investors should take a long-term view and focus on what they can control: a portfolio built on sound principles, adjustments as appropriate and patience.



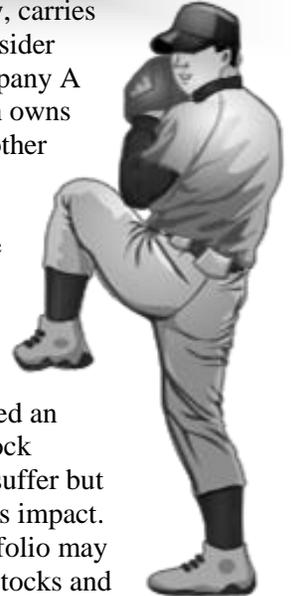
### Diversification<sup>1</sup>

Just as a pitcher with a good fastball needs a curveball or other pitches to make it effective, investing in a single company, even

a very good company, carries unique hazards. Consider owning stock in company A and a portfolio which owns company A plus 99 other stocks.

Of the two, company A would be more impacted if a natural disaster struck their headquarters or their president suffered an accident. The 100-stock portfolio might also suffer but you would expect less impact.

A diversified portfolio may own many different stocks and bonds, in different sectors both in the U.S. and abroad. Spreading your investment dollar around like this is a sound principle and I generally recommend it.



### Call to the Bullpen

Sometimes in the middle of a baseball game you will see the manager replace the starting pitcher with one from the bullpen. He may even replace his ace if he thinks the new pitcher will be more effective.

When investing we sometimes go to the bullpen too. Making adjustments when the economy has shifted or our needs have changed can be appropriate and may be potentially profitable.

After all the coach can do to monitor and make adjustments, he often has to be patient and allow the pitchers to pitch. I believe patience is a principle of effective investing as well.

Investors, like good pitching coaches, should set realistic expectations, accept that there are things outside their control and be patient.

*International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will fall as interest rates rise. No strategy ensures a profit or protects against loss.*

<sup>1</sup> Diversification is subject to risk including possible loss of principal. There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio.