



The Centurion Counselor

Fourth Quarter 2008

UNDERVALUED SECTORS (CONSIDER!)

- GOLD MINING
- CONSUMER DEFENSIVE
- MEDICAL DEVICES
- MEDICAL DIAGNOSTICS

OVERVALUED SECTORS (AVOID!)

- JUNK BONDS
- EMERGING MARKETS
- MONEY CENTER BANKS
- TREASURIES

ANNUAL CRYSTAL BALL

“And the land was overrun by prophets of doom, and with them came four horses and on those horses were four riders, and the names of those riders were Fear and Anger and Gloom and Panic.

And these gloomy, mostly pudgy and balding prophets shouted from the rooftops, predicting the end of happiness, the end of the dollar, the onset of starvation, the collapse of markets globally, and the hegemony of China. And those who prophesized the worst got the most airtime.”

~Stanley Bing writing for Fortune

We could not have said it any better. Bad news sells and that’s still true for the few remaining solvent newspapers (now asking for a Washington bailout, can anyone say “Pravda”), but it is also true for television. Market optimists have often said that it is different this time; but for this recession, it truly is different. During the last recession (2001) we had only one business news cable channel, and it was on the air about 12 hours a day. Business news was delivered by the networks during the business segment of their nightly 30-minute newscast, on a good day, was covered for only two to three minutes. Today, we have four, 24-hour cable business news networks all fighting for attention and that means we need four times the talking heads and four times the gloom and doom.

This pervasive gloom has caused many investors to flee the market at what is most likely the worst time. We have done some research on the biggest percentage days in the history of Wall Street, and discovered, that while some of the numbers today are large, in percentage terms, the biggest gaining days occurred in the 1930s and after the market crash in 1929.

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Page 1



The Centurion Counselor

Fourth Quarter 2008

ANNUAL CRYSTAL BALL (continued)

Best daily performances for the Dow Jones Industrial Average

In percentage terms (based on closing prices)

	Date	Closing Value	Change on Day	% Change on Day
1	March 15 1933	62.10	8.26	15.34
2	October 6 1931	99.34	12.86	14.87
3	October 30 1929	258.47	28.40	12.34
4	September 21 1932	75.16	7.67	11.36
5	October 13 2008	9387.61	936.42	11.08
6	October 28 2008	9065.12	889.35	10.88
7	October 21 1987	2027.85	186.84	10.15
8	August 3 1932	58.22	5.06	9.52
9	February 11 1932	78.60	6.80	9.47
10	November 14 1929	217.28	18.59	9.36
11	December 18 1931	80.69	6.90	9.35
12	February 13 1932	85.82	7.22	9.19
13	May 6 1932	59.01	4.91	9.08
14	April 19 1933	68.31	5.66	9.03
15	October 8 1931	105.79	8.47	8.70
16	June 10 1932	48.94	3.62	7.99
17	September 5 1939	148.12	10.03	7.26
18	June 3 1931	130.37	8.67	7.12
19	January 6 1932	76.31	5.07	7.12
20	October 14 1932	63.84	4.08	6.83

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Page 2



The Centurion Counselor

Fourth Quarter 2008

ANNUAL CRYSTAL BALL (continued)

This is what makes bear markets so difficult: investors panic, get out of equities, and miss out on the rebound. Our research also focused on whether or not the news of a flat market for the last 11 years was correct. Once again, we discovered that there is a difference between perception and reality. At first glance, it appears that the Dow has indeed nearly been flat, closing at 7908.25 in 1997, while closing 2008 at 8776.39, a slight difference of 868.14. This however, does not include dividends, so the raw number is not on a total return basis. Over the course of the past 11 years, an investor in the Dow would have received \$2,241.56 in dividends. This would have produced a total return in excess of 41% or an average of 3.73% per year. Not a barn burner, but roughly equal to the return on treasuries. The difference is equities have a better tax treatment, and the dividends have more than doubled providing for growth in income. Today, the dividend yield on the Dow is greater than that of Treasuries by a wide margin.

We will divide **Our 2008 Predictions**, of one year ago into four categories (1) Those “dead on;” (2) those that were “partially correct”, or, in the opinion of the judges, are not yet fully played out; (3) those that frankly just “missed the mark”; and, (4) those of which we “demand a recount on”.

“Dead on:”

- “Credit Default Swaps (CDS) will become a household word. In essence, they involve selling real risk to an imaginary insurer...but there is no substance.” AIG and Lehman Bros. became the poster children for these massive bets gone wrong. Only a massive bailout by the taxpayers saved the financial system from a complete meltdown.
- “Credit cards, auto loans, and commercial mortgages will also become Wall Street headaches.” The market for all three froze this year with defaults, late payments, and record yields.” The taxpayers are also bailing out this sector with the latest being the loans to MAC.
- “Several municipal bond insurers will file for bankruptcy.” ACA filed for bankruptcy and the other major monoline insurers are on the ropes as the sub-prime crisis spread.
- We said to avoid the following sectors for 2008: “Junk bonds, emerging markets, money center banks and REITs.” The S&P 500 was down 38.6% for the year. The entire world was also down, but the emerging markets did much worse with China down 65%, Russia 72% and India losing 52.43%. The index of emerging markets lost 55.45%. REITs lost on average of nearly 50%. Money center banks lost on average 48% in spite of massive infusions of taxpayer cash. Junk bonds had their worst ever one-year performance as investors fled to the safety of U.S. Treasuries.

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Page 3



The Centurion Counselor

Fourth Quarter 2008

- “The Dollar will rebound this year.” The greenback had a great year rising 8.6% against a basket of the world’s currencies. It did much better against the British Pound up 36.2% and the Canadian Dollar up 22.5%.
- “Housing will remain weak all year.” 2008 began poorly for home prices and then gathered steam to turn a decline into a rout. House prices declined on average in excess of 25%.
- “When the United States catches cold, China will get pneumonia.” The main Bureau of China's Customs said that exports fell 2.2 percent in November for the first time in seven years, while imports dropped 17.9 percent in November.
- From the second half of 2007, the growth of exports has been steadily slipping. According to analysts, inferior quality and products that have been made with toxic chemicals are responsible for the slowdown.
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(2) “Partially correct:”

- “The United States will have a mild recession.” We got the recession part correct but the consensus of economists is that this recession will not be mild. We agree that it will be at least the worst recession in the past 25 years but don’t see it as negatively as much of the press.
- “The Fed will cut rates to 2 ¾%.” We got the cut part correct but they went lower than we believed. In fact Fed Funds are currently at historic lows.

(3) “Missed the mark:”

- “After a weak first six months, equity markets will pick up—mostly to end unchanged for the year.” We got the first half of it right but just as no one remembers who led the Kentucky Derby at the ½ mile mark we missed the finish. The fate of the market was sealed for the year when “too big to fail” Lehman Brothers failed. The market did rally 20% off its lows to end the year on a stronger note.

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Page 4



The Centurion Counselor

Fourth Quarter 2008

(4) “We demand a recount:”

- In review of last year’s 2007 predictions, we said oil would “fall to \$40.” We took the hit last year for being wrong, but what a difference a year makes as the commodity bubble burst sending oil prices under \$35 which was a multi-year low.

Now for the 2009 Predictions

It is fashionable for those who attempt to predict this year’s events to come up with “9 in 09” so we will be different and come up with ten.

1. California will not declare bankruptcy; not because the budget is cut but because the state will get on the Federal dole. This of course is like taking out another credit card to make the payments on the older ones. We do not believe California is out of the woods permanently, just dodging the bullet for one more year.
2. Despite our domestic troubles, we cannot afford to take our eye off the ball internationally. With all the focus on California and the nation’s problems, you may have missed the announcement that Sweden proposes to fix its troubled economy by slashing business, personal income, and payroll taxes. The leader of the country’s liberal party said that among these, the corporate tax rate has a very large effect, because that is the tax that large companies really look at before they set up business. The corporate tax cut will bring their rate down to 26.8%, from a high of 57% in 1987. With the cut, the Swedes will have a corporate tax rate one-third lower than the U.S. average of 39.5% (federal rate plus state average), according to the *Wall Street Journal*. Just as it took a Republican (Nixon) to open relations with China, we believe that it will take a Democrat to reduce corporate tax rates. We are not predicting a reduction in the rate in 2009, but we believe it will start to get serious consideration from the new administration.
3. We have spent the past 10 years going from one bubble to the next; tech, then housing, and now Treasury Bonds. It is our belief that long-term U.S. Government bonds are the most overpriced asset in the world, period! The yield on the bond beginning 2009 was 2.24%. We look for it to climb over 4% by year-end 2009.

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Page 5



The Centurion Counselor

Fourth Quarter 2008

PREDICTIONS (continued)

4. China will fall into official recession (see our score card on last year's predictions) as the pneumonia gripping their financial system, takes hold.
5. The stock market closed 2008 at 903.25 as measured by the S&P 500. We believe that it will close 2009 over 980.00 as the stimulus and government spending brings us out of the recession as the end of the year draws to a close.
6. The recession will end (see above)
7. Commercial real estate will have even more problems, while housing will start to recover. The drop in prices and low mortgage rates are making home ownership affordable once again. This will make apartments the worst performing commercial sector.
8. Inflation will pick up in the fourth quarter after being tame in the first three quarters; overall, inflation will be less than 2% for the year.
9. The dollar will retain its gains made in 2008, while gold will finish the year over \$1,000 an ounce.
10. The savings rate in America, after being near zero for a decade, will increase dramatically; it may well exceed 3% as Americans deleverage and the baby boomers prepare for retirement.

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Page 6