

Impressions

Sweetwater Investments

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Follow Up

Those of my readers who have known me for awhile will testify that I am not given to understatement so you will understand the following comments. My last newsletter on the healthcare debate was without a doubt the most commented on and attacked of anything I have ever written. To some of my critics I have to say- first do you kiss your mother with that mouth? And it is physically impossible to do some of the things you suggest.

The newsletter, in addition to being sent to you gentle reader was sent to three US Senators (Murray, Cantwell and Boxer) and eight US representatives (Reichert, Inslee, Miller, Baird, Woolsey, Eshu, Grayson and Nadler). In addition I sent it to the President. I heard back from three of the 11 in ways other than the canned "thank you for contacting our office, but we really don't care what you think" letter and the sources surprised me. I had feedback from Sen. Boxer but nothing from Cantwell or Murray who represent me. I had angry, vituperative responses from Reps Nadler, and Inslee, thoughtful comments from Baird, and Woolsey.

The majority of the negative comments came from members of the investment community who accused me of being Fox news watching, Rush Limbaugh loving, Glenn Beck worshipping troglodyte and worse. The most cogent of their comments along the lines of if you are so smart what is your solution? Good question. So here goes:

1. I do not accept the argument that access to health care insurance is a fundamental human right. I accept it as potentially something a civilized society creates and perhaps subsidizes for those most in need but only if it can be paid for without borrowing tons of money from people whom wish us no good. I do not believe that everyone should be covered with comprehensive health care insurance and I do not believe it is the responsibility of employers to provide health care insurance.
2. Make the decision if this is insurance or a direct transfer payment. If it is an insurance model there must be rationing as there will never be sufficient capital to pay all the claims. If it is a

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direct transfer that is an entirely different model with different funding and spending protocols.

3. We already have a fairly efficient health insurance delivery system as witnessed by the fact that most Americans are happy with their health coverage. Insurance companies must be allowed to operate freely across state lines removing the fractionalization of health care delivery due to state mandates.
4. All health care insurance should be available as a bundled plan with a menu of coverage and as an unbundled plan where choice can be made on types and levels of coverage and the insured participation in the costs.
5. All health care insurance should be portable from job to job and state to state.
6. No health care plan should be free of cost to the consumer (the employee or insured) if there is no cost to the user the system will be abused. \$ 30 copay is too little.
7. Doctors should be allowed to advertise services
8. Medical malpractice settlements should be limited to \$250,000 in punitive damages but unlimited medical costs reimbursement. While we are on the subject of lawyers the practice of treating contingency fee arrangements as loans to the plaintiff should be ended. If a lawyer takes a contingency fee case they lay out their own money and not get a tax write off for funding a lawsuit. Finally in medical malpractice enact a loser pays all fees construct.
9. Extend the patent protection for new drugs to 45 years.
10. End Congress' exemption from the health care the rest of us have. Make them subject to the same plans we have this should apply to unions and other so called "Cadillac plans".
11. Harmonize tax policy so that large corporations are not subsidized by tax rebates to over insure their workers while at the present time the self employed suffer a significant financial disadvantage in providing health care insurance.
12. Finally, and most controversial, remove government regulations on the provision of health care and allow this to be between the healer and the patient. Increased government regulation will drive providers from the business while national insurance will increase demand without increased supply.

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Nationalism

Born in iniquity and conceived in sin, the spirit of nationalism has never ceased to bend human institutions to the service of dissension and distress"
Thorsten Veblen

Continuing with our series of discussion of the trends that might influence investment decisions in the next few years I would like to talk about Nationalism.

Of all the things that could arise from the current economic crisis and certainly the most dangerous would be a rise in nationalism. Nationalism is not patriotism; in fact it is the exact opposite. Rather than the love of one's nation it is a false love that is paired with a hatred of other nations. In economic crises of the past we have seen the rise of nationalistic movements combining socialism and totalitarianism to form truly frightening monsters. Those monsters feed on blood and are only are only defeated by greater seas of blood.

When there is a great crisis it is common for each person, institution or nation to blame each other. The more finger pointing- the more involved each of the pointers is in the crisis. At the current time all nations have been affected by the fallout of the financial crisis and they are blaming each other and the United States. There can be no doubt that the crisis of 2008 and election of President Obama and a solidly center left Congress is a change in the United States and the nature and direction of our economy.

To a great extent it has been the increasing leverage applied to the US economy over the decades since the end of WWII particularly since the early 1980's that has fueled economic growth around the world. I wonder how many Hermes scarves would have been sold if we had never had a buyout boom or a dot com boom. It is very possible that the US no longer has the economic power or hegemony to drive the world, not because we are weak but because the world is larger and more demanding.

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As the US economy over time de levers it will force other nations to do the same at terrible cost to the national inhabitants. I read recently where the economy of Latvia shrank at an annual rate of 18.9%! Tell me Latvians aren't unhappy! As unhappiness spreads people demand action. Look at the calls for action in the US everything from lynching bankers, to shooting illegals, to armed interventions, to the possible creation of paramilitary super police force. Add in the inevitable, hopefully temporary decline in lifestyles from climate legislation and you have a true witches brew.

It is possible that the crisis will result in the rise of demagogues or extreme nationalists who are convinced that the answer to their nation's problems is to turn inward, away from globalization and to create scapegoats. Given the large nature of the crisis it is not easy for the ordinary citizen of any nation to grasp its total size.

David Faber of CNBC <http://www.cnn.com/id/15838155> has book out called "And then the roof caved in" http://www.hachettebookgroup.com/publishing_little-brown-and-company.aspx which demonstrates the far reaching effects of the mess. We have not even begun to understand how this will affect the world.

There are tremendous strains on nations around the world and in the past those strains have been manipulated by the clever and dangerous to serve evil ends. The case can be made that the true cause of the Great Depression was nationalistic revenge for the imposition of a nationalistic US tariff law.

Can it happen again? As the well worn phrase from Mark Twain says, "history does not repeat itself but it does rhyme." As investors we need to watch out for nationalistic trends not only in other nations but also in the US.

OODA

People using theories or systems evolved from a variety of information will find it increasingly difficult and ultimately impossible to interact with and comprehend phenomena or systems that move increasingly beyond and away from that variety-that is, they will become more and more isolated from that which they are trying to observe or deal with, unless they exploit the new variety to modify their theories/systems or create new theories/systems.

John Boyd –Patterns of Conflict

Col. John Boyd http://en.wikipedia.org/wiki/John_Boyd_military_strategist was a US Air Force fighter pilot during the Korean War and was later assigned the Pentagon where he developed a theory of warfare that has shaped the development of armed forces since the end of the Vietnam War. It is Boyd's

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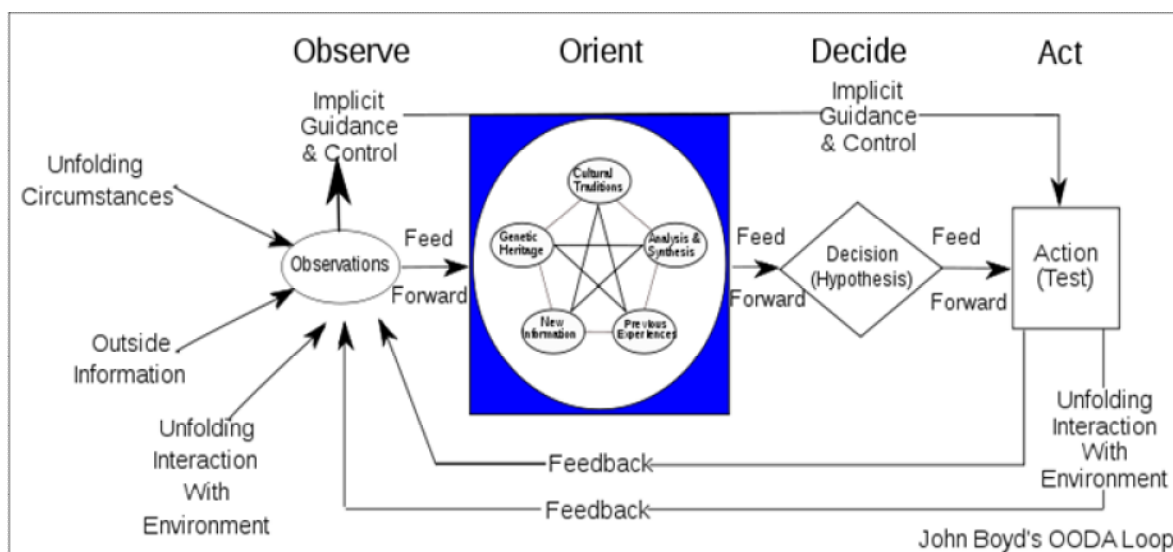
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concepts that lead to the stunning victory of Gulf War I. A good book on his work is *Science, Strategy and War: The Strategic Theory of John Boyd*. Abingdon, UK: Routledge, 2007.

Boyd synthesized a number of concepts into a strategic vision which has come to be represented in oversimplified form as the OODA Loop shown below:



There have been numerous attempts over the centuries to link military strategy to investment success. Many traders and sales persons I have known were very familiar with Clausewitz and Sun Tzu and had as idols George Patton (given the true nature of Wall Street trading rooms they should have been reading vampire books). Most of the linkage attempts have fallen short because they do not focus on the behavioral aspects of Wall Street.

Boyd's strategic vision addresses a major failure in attempting to apply military thinking to investing. In 1492 when Columbus landed in the Bahamas the natives on the shore did not see his ships. Not because they were not present and not because they were blind. The image of the three ships struck their retina but it stopped at the brain. The natives had no experience with devices that looked like ships so

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their brains squeezed the images to something they knew: a giant bird, or an anthropomorphic god. The point is that our brains are hardwired to see things in patterns and things that do not fit the pattern are judged differently.

The patterns we see are determined by the traits in the pentagon within the five pointed star (do you think Boyd a military officer serving in the Pentagon was using patterns he was familiar with?). These are the filters through which everything we sense is passed. Good example, people eat snake and are asked what it tastes like they say chicken not because it tastes like chicken but because it is the closest comparison they have. It really tastes like snake- trust me. If our decisions and actions reinforce the correctness of the observation, it becomes more hardwired.

Here is where it gets tricky. The Heisenberg Uncertainty principal says that any phenomena we observe is changed by our observation. So our observation is changing the phenomena but our orientation which is slower to change stuffs the observation into a recognizable pattern. In Boyd's concept, if you could present the opponent with a situation which they did not recognize, their filtering orientation would cause them to make decisions and take actions that would not be in their best interest, he called this getting inside the OODA loop.

In times of great change we are presented with observations which unfold differently than we expect and the information we are receiving may be wildly at odds with our past experience. For example during 2008 and 2009 we as investors were presented with terms like CMO, CDO, CDO squared, CDS, TARP, quantitative easing, PIPP, TALF all of which most investors wish they were still happily ignorant. Investors have taken the knowledge of these creations and the forces behind the rise of this financial engineering and filtered these observations through an orientation that may be inadequate to fully understand the ramifications.

Had the events of 2007 and 2008 occurred in microcosm they would have been more easily understood. Rarely in my life do such things happen in discrete form, the most dramatic like 2008 and 2001 are usually the most damaging end points of other decisions. While the terrorists attacks were a political act and not a financial one it would not be hard to construct a scenario in which that attack could be framed as part of a series of financial decisions beginning in the aftermath of WWI. Similarly the events of 2007 and 2008 could be framed as the result of decision made in the hype over the millennium issues and the end of the great bull market of the 1990's.

You frequently hear market gurus talk about how the rally since March has not been of high quality as it has been accomplished on lower volume. Is that an observation that appears to be correct and it is confirmed by an orientation developed during lot of years of stock watching? How does the low volume

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square with the existence of “dark pool trading” (Dark pools are stock crossing networks that provide liquidity that is not displayed on order books. See en.wikipedia.org/wiki/Dark_pool).

So the observation of the low volume on the rally should be modified to indicate the rally is occurring on low transparent volume. Since we have no vision to the amount of trading in these dark pools we do not know the true volume attached to the rally. Cynically I wonder if we are not going to see a remake of the famous 1950's movie Creature from the Black Lagoon with the title “Monster from the Black Pool”.

The point is that we are observing a monster rally and some are dismissing it because their observation of low volume is filtered by an orientation that is perhaps out of date and that has lead us (and I add myself to that group) to make a decision that the rally would have short legs and then act by not fully embracing the movement. Col Boyd's concept for the use of the OODA pattern in warfare was to present the opposition with observations that were different than what they expected. That coupled with destruction of communications networks would not allow the enemy to change their orientation allowing victory. One of the oldest sayings in the market is the ‘markets do what makes the most number of people uncomfortable’.

There are a lot of new inputs at the left end of the OODA concept, changing demographics, closer inter-connection of national governments, increased information flow and processing technology, the ability to actually manipulate plant and animal DNA, improved life extending medical treatments and those are the tangible ones. That does not include the “soft issues” such as changing moral compasses, rampant narcissism, balkanization of democracies and others. The questions is to what extent do we modify the items that make up our orientation (if we can) and when. Our individual DNA partly determines how we react and with the advent of DNA manipulation we could be faced with as Huxley called it a “Brave New World”.

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I don't normally spend a lot of time in such deep thoughts but I am become more and more convinced that we have crossed some short of a threshold and the world has been changed forever and I wonder if I am not like T-Rex at the end of the Jurassic Period.

A Word from the COO

Susan Farrell who many of you have had the pleasure of talking to is also the Chief Operating Officer of the Firm. She tells me how to operate- I don't listen sometimes but she never tires of telling me.

I just wanted to mention a questionnaire that we use here at Sweetwater. I know that you get burdened with all the questions you have to answer but this one is fun. We strive to have a close personal relationship with our clients since that allows us to be proactive in looking at the challenges of your life.

In this particular questionnaire that we will be sending to you we ask question about some of your personal likes and dislikes. One of the ways we use this is in our tradition of sending our client's female spouses or partners flowers on their birthday. If we know that you would prefer a potted plant over cut flowers it makes the gift more meaningful. Of course all the information is kept strictly confidential and if you would rather not fill out the questions that is fine.

We do not have a completed questionnaire from all of you so in January we will be sending it out.

Here is some information about me: I' m 63 and loving it!!

I'm a Native of Washington

I have worked for Dennis for 3 years

Here's some information on Dennis: He just turned 63

He has a dog named Frodo

When Dickens wrote A Christmas Carol he had Dennis in mind as Scrooge!

His favorite movie is Gunga Din

Kim's Corner

7 Days - A Genesis Tale

Day 1

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God saw that money was without form, and darkness was upon it.

And God said, "Let there be financial engineering, that money may have form and be multiplied."

And it was so, and God saw that it was good.

Day 2

God saw that there was no one to promote money in all its forms.

And God said, "Let there be Wall Street, that money in all its forms may be spread to the far reaches of the earth."

And it was so, and God saw that it was good.

Day 3

God saw that Wall Street had no one to send out upon the earth.

And God said, "Let there be Salesmen, that the products of Wall Street may have promoters."

And it was so, and God saw that it was good.

Day 4

God saw that the Salesmen had no one to call on.

And God said, "Let there be Prospects, that the Salesmen have someone to call upon."

And it was so, and God saw that it was good.

Day 5

God heard the anguished cries of the Salesmen that they could not make enough money on salary alone.

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And God said, "Let there be commissions, that the Salesmen shall earn bounteous incomes from the Prospects."

And it was so, and God saw that it was good.

Day 6

And God saw that there was wickedness and avarice in Wall Street and the Salesmen, and the Prospects were crying out in anguish.

And God said, "Let there be independent advisors, that the Prospects may receive unbiased advice."

And it was so, and God saw that it was good.

Day 7

And God rested. Finally.

Questions? kimm@sweetaterinv.com

Good Luck and the best to you and your families during the Holiday Season

Dennis Gibb, Kim Miller, Susan Farrell
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