

The Evolution of the Financial Services Business

Over the past 20 or more years, when it comes to managing investments, there have been radical changes in the choices available to investors. Investment products have been democratized and access to even the most esoteric products is now available to the general public. Regulatory changes and dramatic advances in technology have helped move investing into the “virtual world” and onto our desktops. Rather than relying on a stockbroker to provide investment products, individuals can now do it themselves.

As is common with change, this is a good news/bad news situation. The good news is that the proliferation of choices has provided individual investors with access to financial products and strategies that were once available only to the largest institutional investors. The bad news is that many of these investment options are complicated and confusing, leaving people as one pundit suggests, “struggling for knowledge in an ocean of information.” Virtually unrestricted access to complicated financial products can lead to substantial mistakes - and not just for individuals (see following section.) Consequently, many investors prefer to engage an advisor to help them with their investment and planning decisions.

Fortunately, these same regulatory changes and advances in technology have leveled the playing field for financial advisors. There is no longer a need for financial advisors to be employed at large brokerage firms. Today, independent advisors like Horizon are able to offer our clients an appealing alternative to advisors employed by these larger, traditional brokerage firms,.

There is an ongoing, steady migration of investors to independent advisors which can be measured by the growth of two of the largest financial service firms, namely, Fidelity and Schwab. Both of these firms provide custodial services for Horizon clients and specialize in serving clients in the independent advisor marketplace. Fidelity Investments recently surpassed Merrill Lynch as the largest financial service firm when ranked by client assets and, at current growth rates, Schwab will also sur-

pass Merrill in the near future. According to “Investment News,” during the first quarter of 2008, Schwab and Fidelity each gained \$41.3 billion in new assets versus just over \$14 billion for Smith Barney, Merrill Lynch and Morgan Stanley combined. Recent disappointment with the results of these large old-line financial services firms has only served to increase the appeal of independent advisory firms like Horizon.

At Horizon, we are happy to be in the vanguard of these independent advisory firms and look forward to continuing to provide the best in independent, unconflicted advice for our clients and friends. Many thanks for your ongoing support and confidence in our services and for referring your friends and family to our firm.

Leverage + Volatility = Dynamite!

Howard Marks, chairman of Oaktree Capital, expressed this equation, which we think, aptly describes the recent meltdown in the credit markets. But the question remains: how could so many (apparently) really smart people – the folks who operate and manage the largest financial companies in the world – have, collectively, made such huge mistakes?

We believe that much of this meltdown is due to the market’s accepted status quo, or “Situation Normal” drifting into new territory. Folks were able to borrow more and more money, which pushed asset values higher and higher. This became a self reinforcing cycle. The higher housing prices went, the more people thought they would continue to rise and rising prices led to low defaults. Pretty soon, all of this activity came to be considered “normal” and lenders were happy to extend credit to the least credit-worthy, seemingly without any increase in commensurate risk.

Ken Fisher, in his book, The Only Three Questions that Count, suggests that the first question that investors should ask themselves is “What do you believe that’s actually false?” It’s apparent in retrospect that many folks

abandoned this line of inquiry and ventured head-long into these markets, unhindered by discipline or restraint. Once sub-prime borrowers began defaulting and market participants realized that there was, indeed, more risk to these strategies than they expected, the music stopped and there was nowhere to hide. There is a term in psychology which fairly explains the reckoning which occurred earlier this year. Known as "Cognitive Dissonance," it is a phenomenon which refers to the discomfort one feels when there is discrepancy between (a) what you know (or think you know) to be fact and (b) a reality which doesn't square with your expectations. Something you understand to be true is, in fact, not true.

As investors are coming to grips with this new reality, the market has adjusted in fits and starts. These collections of bad decisions are stacking up, one upon the other, resulting in ongoing confusion and uncertainty about the stability of financial markets, both domestically and internationally. The new found risk aversion and resulting "deleveraging" of the financial marketplace continues to create significant liquidity problems. These problems have resulted in huge losses, ranging from the effective dissolution of Bear Stearns to the recent announcement that UBS lost \$11 billion in the first quarter alone. They are not just affecting these large banks, but all investors. And the uncertainty continues...

According to one bank spokesman commenting on the illiquidity in the "auction rate" securities market, "Given the unprecedented nature of the liquidity issues... we cannot predict how or when the market will recover." This comment was made by the same folks who assured investors that these securities were really just like cash, you just needed to give seven days notice to get your money. Well, that has turned out to be an empty promise and many retail and institutional investors are effectively stuck with illiquid, unmarketable holdings. This condition will persist until the debt issuers either refinance these short term securities or the money center banks and investment banks have the liquidity (and financial incentive) to return to making a market in these issues. To be clear, before the credit crisis began, these same banks acted as (well compensated) middlemen in this market playing an active role in liquidity by brokering these securities to their clients.

We are fortunate to have avoided most of these particular problems in our portfolios. Our portfolios have declined, due to the systematic nature of the overall credit problems, but our clients have had little exposure to these really troublesome investments.

Market Review

The following table shows market index returns for 2008 through April 30th, trailing 12-months and past 3 years.

Index (Through 4/30/2008)	YTD	1-Year	3-Year
S&P 500 (Large Stocks)	-5.64%	-6.53%	19.77%
Russell 2000 (Small Stocks)	-6.51%	-12.08%	23.61%
EAFE (International Stocks)	-5.05%	-4.29%	46.26%
Lehman Bond Aggregate	2.11%	7.43%	16.93%

The hope and optimism that normally follows a new year quickly faded in January as the stock market began one of the worst beginnings it has ever recorded. What began as "volatility," quickly evolved into steep and gut-wrenching losses that culminated into double-digit declines for most major market averages in just the first few weeks of the year. The market slid relentlessly until policy-makers quickly stepped in to restore confidence by slashing interest rates, offering liquidity, and promising additional tax refunds to American consumers.

These swift and aggressive moves seem (for now) to have had the desired impact. Although the market was down considerably for the first quarter, the S&P 500 actually rose 0.9% from its late January low and followed that up with a 4.8% rise in April. Through the end of April, the S&P 500 was down only a "mere" -5.6% for the year.

In the face of the spiraling economy and stock market, the Federal Reserve responded by sequentially and aggressively cutting the Fed Funds rate from 4.75% to 2.00% over the past four months. In addition to this conventional tactic, Fed Chairman Ben Bernanke has also employed several unconventional strategies that have injected liquidity into the financial system, containing the threat of a collapse of the financial system.

The most aggressive and unusual move came in March

when the Fed intervened to stop the collapse of Bear Stearns. Bear Stearns, once regarded as one of the pre-eminent Wall Street firms, quite suddenly found themselves in a "crisis in confidence" by their creditors. Rumors began to circulate that Bear Stearns could not satisfy their outstanding lines of credit. Once enough of Bear's creditors came to collect, an old-fashioned "run on the bank" ensued. The Fed, recognizing the danger this presented to the financial system, reacted quickly by stepping in to negotiate a rescue purchase of Bear Stearns by JPMorgan.

Contrary to the progress that has been made in the financial system, the residential real estate market has continued to struggle. Staggering losses in California, Florida, and Nevada have punctuated one of the worst housing declines since the great depression. Weakness in the real estate market brought about the tipping point that created so much turmoil in the financial system and in the stock market. Moving these key markets back into an affordable range will likely be the key ingredient to the housing market finding its bottom. No one is sure when that might be, and for now, the declines are expected to continue.

In concert with the multiple issues in housing and the banking system, the health of the economy has come into question. Real GDP grew by a paltry 0.6% for the past two quarters and unemployment has been on the rise. In addition, commodity prices combined with the weakening dollar have ignited inflationary concerns. The most visible evidence of this has been the steep rise of energy prices since the beginning of the year. This meteoric increase can be partly explained by fundamental supply and demand, but there has also been a surge of speculative money chasing recent hot performance in commodities, particularly oil.

While we remain focused on the state of the economy and the stock market, we are at the same time thankful that our clients' portfolios have fared the recent turbulence reasonably well. Better than expected corporate earnings and a slower than expected rise in unemployment have been welcome signs of light at the end of what has felt like a long, dark tunnel. We are optimistic that by the end of the summer, the worst of this crisis will have passed and that we might end the year on a positive note.

Thank you very much for your continued confidence in our service and advice. If you have any questions, comments, or would like to schedule some time to come by and review your goals and objectives, or to just visit, please call.

Manager Spotlight— AllianceBernstein Int'l Value

As local economies around the globe have become more and more intertwined, it is increasingly important that our clients not only invest in the United States, but internationally as well.

AllianceBernstein, an institutional asset management firm based in New York, has established itself as a global leader with more than \$750 billion in assets under management. Over many decades they have developed an outstanding research staff of more than 100 investment professionals in offices around the world including New York, London, Tokyo, Hong Kong, and Sydney. They utilize this global footprint in the management of all of their funds, but in no fund is this worldwide presence more important than in their International Value fund.

The AllianceBernstein process begins with a proprietary valuation model that ranks securities by their investment attractiveness. They then focus on the most appealing companies, conducting an intensive examination of the business, industry, and underlying fundamentals to determine if it would be a beneficial addition to the portfolio. New investments are then presented to the portfolio management team for final approval. The overriding focus in this process is to select only those securities with the highest potential for return opportunities.

The International Value mutual fund takes this process and applies it to opportunities around the world. They seek investments not only in large developed countries like the U.K. and Japan, but also in emerging countries located in South America, Asia, and the Middle East. They have the flexibility to buy securities either in U.S. markets or in foreign markets. They also control foreign exchange risk by using derivatives to link their investments to particular currencies which give clients the added benefit of managed foreign currency exposure.

The fund is managed by a team of four senior portfolio

managers who combine for nearly 80 years of investment related experience. The team is led by Sharon Fay who operates out of the London office. She has a BA from Brown and an MBA from Harvard. She has been with AllianceBernstein for more than 18 years. She is supported by Kevin Simms, Henry D'Auria, and Eric Franco who are all based in the New York office.

We have selected the Alliance Bernstein International Value fund for our clients because of their process, skilled investment team, and long track record of superior risk adjusted returns. As with all of our recommended investment managers, we will continue to monitor the performance and process of this fund to assure it delivers the quality and performance we expect for our clients.

Disclaimer: This manager (AllianceBernstein Investment Management) is responsible for managing one or more investments recommended in the past by Horizon Advisors. A complete list of all investment recommendations Horizon Advisors has made in the past 12 months is available upon request.

Making Cents

The SEC has recently released the results of a study prepared by the Rand Corporation, which confirms that there is a huge knowledge gap among consumers of financial services as to the business practices of the advisors who provide consumers with financial advice. Financial service providers are subject to one of two different standards when advising their clients. An advisor is held to either a fiduciary standard or a suitability standard.

A fiduciary standard requires a person to act on behalf of another, in good faith and with care, candor, and loyalty in fulfilling their obligation. This is the standard of care which applies to a trust company or a trustee. Planners and advisors, like Horizon, who are registered with the Security Exchange Commission are known as registered investment advisors and have this fiduciary obligation to clients, a legal requirement to always put a client's needs first. This fiduciary responsibility is the highest legal duty that one party can have to another.

The suitability standard, which applies to brokers subject to the rules of the Financial Industry Regulatory Authority, requires that an investment strategy or transaction be appropriate, in light of an investor's financial means and investment objectives. In other words, an advisor subject to this suitability standard is required to have a reasonable basis for recommending a security or investment strategy, but is not held to the higher duties inherent in the fiduciary standard.

We think that this is a very clear distinction. Suitability does not require the same level of care as that required for a fiduciary. As we mentioned at the beginning of this newsletter, there are a world of changes in the advisory business today and many more advisors are beginning to embrace the higher duties of a fiduciary standard. In considering an advisory relationship, you would be well advised to make sure to understand which standards they embrace.

COLLECTED THOUGHTS

*"Liquidity is taken for granted until it's no longer there."
- Warren Buffett*

Estate Planning

Tax Planning Services

Investment Management

Private Foundation Administration

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