



# Auxier REPORT

5000 SW Meadows Road, Suite 410, Lake Oswego, OR 97035 Phone 503.885.8807 1.800.835.9556 Fax 503.885.8607 Email info@auxierasset.com

J. Jeffrey Auxier

## AUXIER FOCUS FUND PERFORMANCE UPDATE December 31, 2008

### AUXFX RETURNS VS. S&P 500 INDEX

	<u>Auxier Focus Fund</u>	<u>S&amp;P 500 Index</u>	<u>Difference*</u>
09/30/08 – 12/31/08	-14.65%	-21.94%	7.29
12/31/07 – 12/31/08	-24.52%	-37.00%	12.48
12/31/06 – 12/31/07	5.71%	5.49%	0.22
12/31/05 – 12/31/06	11.75%	15.79%	-4.04
12/31/04 – 12/31/05	4.58%	4.91%	-0.33
12/31/03 – 12/31/04	10.73%	10.87%	-0.14
12/31/02 – 12/31/03	26.75%	28.69%	-1.94
12/31/01 – 12/31/02	-6.79%	-22.10%	15.31
12/31/00 – 12/31/01	12.67%	-11.88%	24.55
12/31/99 – 12/31/00	4.05%	-9.10%	13.15
Since Inception 7/9/99	47.22%	-24.30%	71.52

\* in percentage points

<b>Average Annual Returns for the period ended 12/31/08</b>	<b>1 Year</b>	<b>3 Year</b>	<b>5 Year</b>	<b>Since Inception</b>
<b>Auxier Focus Fund (Investor Shares)</b>	<b>(24.52)%</b>	<b>(3.75)%</b>	<b>0.65%</b>	<b>4.16% (7/9/99)</b>
<b>S&amp;P 500 Index</b>	<b>(37.00)%</b>	<b>(8.36)%</b>	<b>(2.19)%</b>	<b>(2.89)%</b>

Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than original cost. As stated in the current prospectus, the Fund's annual operating expense ratio (gross) is 1.35%. The Fund's adviser has contractually agreed to maintain annual operating expenses at 1.35%, which is in effect until October 31, 2008. The Fund charges a 2.0% redemption fee on shares redeemed within six months of purchase. For the most recent month-end performance, please call (877)328-9437 or visit the Fund's website at [www.auxierasset.com](http://www.auxierasset.com).

Before investing you should carefully consider the Fund's investment objectives, risks, charges and expenses. This and other information is in the prospectus, a copy of which may be obtained by calling (877) 328-9437 or visiting the Fund's website. Please read the prospectus carefully before you invest.

Fund returns (i) assume the reinvestment of all dividends and capital gain distributions and (ii) would have been lower during the period if certain fees and expenses had not been waived. Performance shown is for the Fund's Investor Class shares; returns for other share classes will vary. Performance for Investor Class shares for periods prior to December 10, 2004 reflects performance of the applicable share class of Auxier Focus Fund, a series of Unified Series Trust (the "Predecessor Fund"). Prior to January 3, 2003, the Predecessor Fund was a series of Ameriprime Funds. The performance of the Fund's Investor Class shares for the period prior to December 10, 2004 reflects the expenses of the Predecessor Fund.

**The Fund may invest in value and/or growth stocks. Investments in value stocks are subject to risk that their intrinsic value may never be realized and investments in growth stocks may be susceptible to rapid price swings, especially during periods of economic uncertainty. In addition, the Fund may invest in smaller companies which generally carry greater risk than is customarily associated with larger companies for various reasons such as narrower markets, limited financial resources and less liquid stock. Moreover, if the Fund's portfolio is overweighted in a sector, any negative development affecting that sector will have a greater impact on the Fund than a fund that is not overweighted in that sector.** Foreside Fund Services, LLC, distributor.

## Year-End 2008

### Market Commentary

The Auxier Focus Fund returned -14.65% in the fourth quarter of 2008, versus -21.94% for Standard and Poor's 500 Index (S&P 500). For the full year the Fund returned -24.52%, versus a -37% in the S&P 500. The S&P's loss for 2008 was the worst since 1937. Although we outperformed the market by over 12 percentage points, we aren't happy with simply losing less than the market. We correctly identified many of the excesses, but failed to totally eliminate exposure to those areas that were vulnerable to a contracting credit cycle.

The pendulum has swung from excessively cheap money in the summer of 2007. In 2007, the spread between yields on high and low risk bonds compressed to historic lows under 3 percentage points. In the fourth quarter of 2008, the spread exceeded 21. This credit crunch was widespread and impacted asset prices on a global level. The following shows returns for various indices and asset classes for 2008:

#### Stock Market Indices:

- Wilshire 5000 Equal Weight Index -44.96% (the broadest measure of U.S. stocks)
- The NASDAQ Composite Index -40.5%
- Japan Nikkei 225 Index -42%
- Chinese Shanghai Index -65%
- Brazilian Bovespa Index -41%
- Russian RTS Index -72%

#### Commodities and Real Estate Indices:

- Reuters/Jefferies CRB (Commodity Research Bureau) Index -35%
- The S&P/Case-Schiller Home Price Indices -18% (through November)
- Dow Jones Wilshire REIT (Real Estate Investment Trust) Index -39.2%
- Lipper Natural Resources Funds Average -49.58%
- Crude Oil -54%

### Perils of Excessive Borrowing

The proverbial tide has gone out exposing the shocking extent of hidden leverage utilized by top financial institutions across the globe. "Velocity" replaced quality. Obscure "off balance sheet" borrowings were employed to supercharge returns on invested capital. The problem during an economic downturn is that assets go down but the liabilities remain solid. The coordinated effort of hedge funds (\$2 trillion of assets at their peak) and investment banks led to off-the-charts leverage ratios often exceeding 40 to 1. We are now in an environment of deleveraging and forced liquidations that has impacted virtually every asset class around the world.

Another area of opaque growth, outside the scope of reporting and sensible regulation, was the credit default swap (CDS) market. In less than seven years, these insurance contracts grew from \$900 billion to over \$60 trillion before crashing to today's more modest \$29 trillion. This represents a new insurance industry, with no capital requirements or clearing exchange, where hedge funds are major players. Just six months ago American International Group (AIG) had a AAA credit rating. Then, thanks to "off the books" CDS exposure, AIG got a whopping collateral call from the U.S. government totaling \$130 billion. Conflicted ratings agencies accentuated the crisis by failing to accurately analyze and communicate underlying risk in the system. In an effort to enhance investment returns, Wall Street investment banks, hedge funds and private equity firms were all operating with just too much hidden borrowed money compared with the underlying capital.

Last quarter we commented on the "600% in six" phenomenon, where a red-hot investment class appreciates roughly 600% in six years. Examples: the NASDAQ from 1994-2000, Chinese stocks from 2001-2007, oil from 2002-2008. Each move was followed by a correction exceeding 70%. Part of the reason for the dramatic correction was the growth in debt (and now derivatives) that generally accompanies the rise—especially as you get close to the top. Enthusiasm, inflated assets and borrowed money are a lethal concoction. Oil was the most recent casualty, dropping from a high of \$147 a barrel into the \$30s.

Other financial products under the realm of “structured finance” became the foundation of the oft-cited “toxic assets” that the government is now wrestling with. By packaging loans and then reselling them to investors, investment bankers created a system based on generating product as fast as possible without regard to quality. Mortgages were generated, pooled, and stamped with AAA ratings and marketed across the world. This helped to contribute to the “easy money” backdrop that infected lending for auto, credit card, sub-prime mortgages, Alternative A paper mortgages, jumbo mortgages, commercial real estate, etc. It enabled U.S. consumers to live far beyond their means. This “securitization” market at its peak exceeded standard bank loans. Now investors won’t go near these pools. The clock has struck twelve and the “instant gratification” party is over. The American consumer has turned frugal to the detriment of not only the U.S. economy, but also economies across the world that export into the U.S.

### **Correcting the Problems**

A key to the recovery will be the speed, clarity and decisiveness with which the banking industry is able to separate bad assets, admit errors, and set bargain basement prices to purge the system. The market, if allowed, will correct the folly of taking on too much debt via the purchase of overpriced assets. Trying to bail out mortgage holders who made mistakes can’t work, because most of the problem loans have been pooled into securities representing varying economic rights. The foreclosure process will work as it helps to set low clearing prices that can attract more private capital. The U.S. private sector currently sits on close to \$9 trillion in short term cash assets (over 75% of the value of U.S. stocks) that will move once the playing field is clarified and bargain prices are presented (*Bloomberg*). During the last thrift crisis, the Resolution Trust Corporation effectively gathered bad assets then offered fire-sale prices that helped to move unwanted inventory, bringing supply and demand back in line, thus leading to equilibrium. Until that takes place there will be no trust in the balance sheets of financial institutions, and investors will continue to shun them.

### **Government Policy Response**

It is important to closely monitor government policy response and leadership. Just as the managers of a company need to be scrutinized for their capital allocation decisions, policy response requires careful study. Unfortunately, from 2003-2007, we have just witnessed the fastest increase in state and local spending in history, up 34% versus 5% population growth. According to the Census Bureau, state and local spending budgets have more than doubled to \$2 trillion since 1998. Generally, big government stimulative spending programs like the New Deal in the 1930s (and the Japanese equivalent during the 1990s) were failures. Small businesses are the key to innovation, entrepreneurial spirit and job creation. They are better able to adapt to markets than big companies and operators typically have “skin in the game.” The U.S corporate tax is currently the highest among industrialized nations. We are also close to the bottom in terms of investment in retraining. We need to have a nation that is constantly being retooled and educated over a lifetime to fulfill the constantly changing demands of the economy.

### **Investing in Challenging Times**

In a crisis of capital shortfall, one’s top priority is to focus on dependable cash flows and balance sheet repair. There is simply too much borrowed money in the system that needs to be reduced. American households have been living beyond their means for years. They are radically changing spending habits to build in a margin of safety as they see friends and family lose jobs and homes. For companies, capital spending and employees will likely suffer to maintain balance sheet stability.

In the fourth quarter, we were able to buy a number of corporate bonds whose yields represented some of the highest spreads since the 1930s. These companies sell “necessity” type products that have endured during the most difficult of times. The goal is to maximize secure cash flow while we weather the storm, watching for an uptick in fundamentals. The risk/reward is favorable for a senior creditor during this time of restructuring, and allows us to keep close tabs on the pulse of cash flows.

Common stock ownership ideally should center on low-cost, well-managed franchises that are totally self-funding (independent of borrowing needs) and churn out free cash. Companies with nominal mandatory capital expenditures are best. Solid dividend returns will be of greater importance in a slowing economy. Understand that bear markets are grinding, frightening affairs that might be compared with a painful but necessary detoxification process to purge the system. In this case the addiction is to cheap money. It will take time. We work hard to mitigate the downside

shocks during this corrective time. We know that the acute pain all investors feel threatens to derail the persistence it takes to achieve positive investment returns. Over the years, we have found it is better to focus on preserving capital while monitoring for an upturn in fundamentals, even if we are a little late off the bottom.

## **Preserving Clients' Capital**

For the serious, long-term investor with liquidity, we believe this is a tremendous time to carefully seek attractive investments. We maintain what are known as "market agnostic" positions and cash-like liquid investments that can provide positive returns. Examples include workouts, or corporate bonds where the return is based on a managerial event, not the supply and demand of the auction markets.

Most investors fail to realize that when money is tight, there is a very high correlation among asset classes, and it is to the downside. So diversification doesn't really help. Over the years some of our investors have questioned this posture, thinking they were missing out. However, 25 years of experience through a number of tough markets has ingrained a healthy respect for the downside and how rapidly markets can turn. We like to maintain liquidity and invest when the odds are favorable on a risk/reward basis. Famed financier Bernard Baruch always had cash in his investment account to take advantage of the investment opportunities that can arise virtually overnight.

Since 1947, there have been only 11 out of 244 periods in which the Gross Domestic Product (GDP) turned negative—less than a 5% probability. So recessions do not occur 95% of the time. If you look back at those 11 periods as a time to invest or sell, clearly if you "price" your investments, it is the time to be serious about diligent homework and allocating capital. Just prior to the 1973-74 decline, 50 of the most popular large-cap stocks (the "Nifty Fifty") were trading over 80 times earnings. They were thought to be safe, one-decision stocks. You bought them and that was your decision. Ironically, market tops are the time when investors perceive little risk. Yet, at the bottom less than 18 months later, those same issues were trading under 10 times earnings. Everybody thought the "sky was falling" and wouldn't touch them. Ditto technology stocks in March of 2000. As the NASDAQ was trading over 100 times earnings, technology stocks were perceived as low risk and over \$400 billion flooded into growth stock funds. Such herd reactions reinforce the need for a consistent, research-intensive approach that never forsakes the primacy of price and value.

Market tops are often accompanied by euphoria and excitement, with parabolic moves up in a short period. Just the opposite usually happens at the bottom of bear markets. Jeffrey A. Hirsh of the *Stock Trader's Almanac* recently revisited the past bear market bottoms since 1950. He found bottoms to be preceded by scary, precipitous plunges in which fear, desperation and helplessness prevail. Plunges ranged from 12% to 28% and two to four months in length. The recovery time off the bottom was often just as volatile. For example, stocks bounced off the 1982 low some 40% in less than 90 days. Going back to 1900, there have been six U.S. market declines similar in magnitude to the 2008 fall. They all bottomed after a duration of two years, declining about 50%. In four out of the six, the market fully recovered to the pre-crisis peak within 18 months. In 108 years, there have been only six markets that have been as bad as this past year.

## **Closing Thoughts**

We take our position as stewards of client assets seriously. Auxier Asset Management has been debt-free since inception in 1998. We strive to operate conservatively, with a long-term orientation and full disclosure. We are mindful of the importance of preserving hard-earned capital, especially during this difficult economic climate.

Thank you for your continued trust.

Jeff Auxier

The S&P 500 index is a broad-based, unmanaged measurement of changes in stock market conditions based on 500 widely held common stocks. The Nasdaq Composite Index measures all Nasdaq domestic and non-U.S. based common stocks listed on The Nasdaq Stock Market. The Japan Nikkei 225 Index is a stock market index for the Tokyo Stock Exchange. It is a price-weighted average (the unit is Yen), and the components are reviewed once a year. The Chinese Shanghai Index is a capitalization-weighted index of stocks on China's Shanghai Stock Exchange. It tracks the daily price movement of all shares on the exchange. The Brazilian Bovespa Index is a total return index weighted by traded volume and is comprised of the most liquid stocks traded on the Sao Paulo Stock

Exchange. The Russian Trading System Index is a capitalization-weighted index that is calculated in USD. The index is comprised of stocks traded on the Russian Trading System and uses free-float adjusted shares. One cannot invest directly in an index.

Reuters/Jefferies-CRB Index has served as the most widely recognized measure of global commodities markets. As a benchmark, the Reuters/Jefferies-CRB Index is designed to provide timely and accurate representation of a long-only, broadly diversified investment in commodities through a transparent and disciplined calculation methodology. The S&P/Case-Shiller Home Price Indices measures the residential housing market, tracking changes in the value of the residential real estate market in 20 metropolitan regions across the United States. The Dow Jones Wilshire REIT Index measures U.S. publicly traded Real Estate Investment Trusts. This index is a subset of the Dow Jones Wilshire Real Estate Securities Index. Lipper Natural Resources Fund Index is the average of the 30 largest funds in the Lipper Natural Resources Funds Category.

An Alternative A-paper, is a type of U.S. mortgage that, for various reasons, is considered riskier than A-paper, or "prime", and less risky than "subprime," the riskiest category. A jumbo mortgage is a mortgage with a loan amount above the industry-standard definition of conventional conforming loan limits.

The credit ratings mentioned above are published rankings based on detailed financial analyses by a credit bureau, specifically as it relates to the bond issuer's ability to meet debt obligations. The highest rating is AAA, and the lowest is D. Securities with credit ratings of BBB and above are considered investment grade.

The **Resolution Trust Corporation (RTC)** was a United States Government-owned asset management company charged with liquidating assets (primarily real estate-related assets, including mortgage loans) that had been assets of savings and loan associations (S&Ls) declared insolvent by the Office of Thrift Supervision, as a consequence of the savings and loan crisis of the 1980s. It also took over the insurance functions of the former Federal Home Loan Bank Board. In 1995, its duties were transferred to the Savings Association Insurance Fund of the Federal Deposit Insurance Corporation.

*The views in this shareholder letter were those of the Fund Manager as of the letter's publication date and may not reflect his views on the date this letter is first distributed or anytime thereafter. These views are intended to assist readers in understanding the Fund's investment methodology and do not constitute investment advice.*