MARKET COMMENTARY – NOVEMBER 2008

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Dear Clients,

So far this has been another crazy week in the markets, with stock prices falling, and then rising again dramatically, with moves of 5-10% on a daily basis. Given everything that has happened in the financial markets since the beginning of October, I think this is a good time to take a step back from the daily news and stock market reports to look at the big picture. So here is my current perspective on the markets and our long term investment strategy. My apologies to current clients who have already seen some of this information in your recent quarterly reports.

FIRST THE BAD NEWS - There is no shortage of bad news to consider in this market, as we can see every day in the newspapers and on TV. But here are some of the big issues:

- The US housing crisis continues, as home prices fall, mortgage delinquencies and foreclosures increase, and more homes are put on the market, driving prices even lower.
- The credit markets are still very tight, with tough lending standards and relatively high interest rates for banks, businesses, and home buyers.
- Consumer spending has pulled back significantly because of the housing and credit crisis and fear of job losses and unemployment.
- Layoffs and unemployment move higher and higher, as businesses cut back on hiring and spending to deal with the economic slowdown.
- The economic slowdown has turned into a global recession, with slowing or negative economic growth in the US, Europe, Asia, and emerging markets.
- US auto makers are bleeding cash, and begging for their own government bailout to prevent bankruptcy and potentially significant job losses.
- Mutual funds and hedge funds have been forced to sell investments at current prices in order to raise cash and fund redemptions by investors.
- Equity markets have fallen dramatically over the past year, down about 40% in the US and 50% in international markets.

NOW THE GOOD NEWS - Most of these items are only "good" news relative to the huge problems listed above. But as an investor, I believe they are generally good for the economy and markets:

- Massive government intervention, including large investments in the financial services industry, has prevented a complete collapse of the banking system.
- Aggressive monetary policy, including coordinated global interest rate cuts, should ultimately help thaw frozen credit markets and stimulate a return to economic growth.
- Expansive fiscal policy, including proposed economic stimulus packages in the US and China, will create jobs and support the global economy, at least in the short term.
- Oil and other commodity prices have fallen dramatically, reducing the cost to businesses and consumers, and providing additional economic stimulus.

- Now that the US election is done, there is less political uncertainty, and we can transition from an unpopular "lame duck" administration to new leadership over the next few months.
- Stock markets have already "priced in" expectations of a severe global recession with a likely market bottom established in October, which has been "tested" several times since then.
- Current valuation metrics for stocks (P/E ratios and dividend yields) and corporate bonds (risk premiums) are very attractive at today's prices.
- There is a huge amount of money on the sidelines, with a record $3 trillion in money market funds yielding an average of 1.3%.

THE HISTORICAL PERSPECTIVE - Although this recession may be longer and deeper than all of the others, it is still useful to look at the history of past recessions for information on market behavior:

- We have had 10 recessions since World War II, and these recessions have lasted an average of 10 months.
- The average downturn in the stock market (S&P 500) during these recessions has been about 25% over a 1 year period from peak to trough.
- On average, the stock market peaked 6 months before the recession began and bottomed out 4 months before the recession ended.
- Individual investors tend to increase their allocation to stocks near market peaks and decrease their stock allocation near market bottoms.
- On average, the stock market was up 23% in the 6 months after the market bottom and up 32% in the one year period after the market bottom.

MY RECOMMENDATIONS - As I have already discussed with most of my existing clients, here are my current recommendations for your long term investments:

- Make sure you have enough cash reserves on hand to deal with your short term needs and any potential emergencies.
- Resist the urge to sell your equity investments now, despite the bad economic news, as we are probably near a market bottom.
- Review your long term asset allocation strategy to make sure it is still in line with your time horizon, return requirements, and risk profile.
- If you are fully invested at your long term asset allocation, be patient, ignore the daily market moves, and rebalance your portfolio as needed.
- If you have excess cash in your portfolio, consider adding to your investments over the next few months as markets stabilize and begin to recover.
- If you have unrealized capital losses in your taxable accounts, implement a "tax loss harvesting" strategy to realize these losses before year end.

As always, feel free to call me if you want to discuss any of these topics or your own investment strategy…