# MARKET COMMENTARY – OCTOBER 2008

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Dear Clients,

As I am sure you know, the US government approved the financial bailout/rescue package late last week. However, the global equity markets continued to fall this week, down another 8-9% in the last couple of days alone. Over the past year, equity markets are down 35% in the US and 40% around the world. There is fear, uncertainty and panic in the markets right now. Investors are still concerned about the credit crisis, wondering if the $700 billion rescue package is too little too late, or will even work at all. At the same time, the turmoil has spread to Europe and other international markets; it is not clear how and when foreign governments will act with fiscal and monetary policy to help deal with the crisis. Finally, and most importantly, even if we fix the credit crisis and restore confidence in the banking system, we still have a global economic slowdown/recession which will take some time to recover. The only good news is the continued reduction in energy prices resulting from the economic slowdown.

At this point we are all feeling the financial pain and impact of this bear market on our long term investments. And we are all worried about the future. There is nothing I can say that will make you feel better right now. Like most financial advisors, I have already recommended a continued focus on the long term strategy, including a well-rounded asset allocation and a broadly diversified portfolio. But this financial crisis is worse than any of us could have imagined. So the big question is whether we are near the bottom or if things are going to get a lot worse before they get better. Unfortunately, I can't predict the future with certainty. But I would like to offer some potential scenarios so we can plan for the future together. In my view of the future, here are the best case, worst case and more likely scenarios for you to consider:

**1. Best Case Scenario:** In this scenario, governments around the world act in a coordinated strategy to restore confidence in the banking system, add liquidity to the markets, and free up credit for individuals and businesses. This scenario includes quick and successful implementation of the bailout package by the US Treasury, and similar strategies by governments in Europe and Asia. It also includes global interest rate reductions by central banks around the world to reduce the cost of borrowing and stimulate the economy. In this scenario, we avoid a financial meltdown, restore confidence in the markets, and stimulate growth in the global economy. The result is a mild to moderate economic slowdown or recession, followed by a quick recovery in the next year. If this happens, the markets will bounce back up when confidence returns to the financial system and then continue recovering over the next year. In my opinion, this scenario is possible, but not likely. However, if you believe in this scenario, you may be inclined to add to your equity investments in the near future to take advantage of the bounce back and recovery from an oversold market.

**2. Worst Case Scenario**: In this scenario, government action or inaction makes the financial crisis worse, investors and customers lose all confidence in the banking system, financial institutions continue to fail, requiring takeover by the government or another bank, and so on. The freeze in the money and credit markets causes the global economy to spiral down into a very deep recession or even another depression. The result is a significant and long term reduction in global economic activity, very high unemployment, and asset price deflation. Equity markets will continue to fall as the news gets worse. In my opinion, this scenario is possible, but not likely. However, if you believe in this scenario, you might consider selling some of your equity investments now and stay on the sidelines until you believe the risk of a deep recession is past. The risk of this strategy is that you could miss out on some or most of the recovery by trying to time the market.

**3. More Likely Scenario:** In this scenario, the financial bailout package begins to take effect in the next few months and is combined with a variety of fiscal and monetary stimulus efforts by governments around the world. But the process takes a long time and the results are mixed. After some additional bank failures, government takeovers and industry consolidation, confidence in the financial markets begins to grow and credit begins to flow again, but very slowly. Over the next year, the global economy continues to weaken into a serious recession, with continued job losses and increasing unemployment. Lower interest rates and falling energy prices, and more fiscal stimulus from government are needed to get the economy moving again. In my opinion, this is the more likely scenario. I also believe the equity markets have already priced in such a scenario, including a serious recession and a slow recovery over the next year or more. I recently read that since World War II, we have had 10 bear markets with an average market decline of 31.5% in the S&P 500 index. We have already passed that point. As one financial expert suggested on CNBC, this means it is "too late to sell and too early to buy". So if you believe in this scenario, as I do, you should maintain your long term asset allocation strategy, continue to focus on the long term, and avoid trying to time the market.

I hope this will give you a way to think about and plan for the future in a rational way. Please call me if you would like to discuss, especially if you are convinced that the worst case scenario is likely and want to reduce the equity exposure in your portfolio. Otherwise, I will contact you in the next couple of weeks to review your investment report for the third quarter.