

## **Fannie & Freddie Who?**

**9-09-08**

**As the subprime mortgage sinkhole continues claiming victims, most recently Fannie Mae and Freddie Mac, it seems an appropriate time to share our thoughts once again.**

**Warren Buffet, Omaha's and America's investing guru, once said that his favorite holding period for stocks is "forever". We at Financial Freedom could not agree more. As avid buy and hold investors, we practice Buffet's philosophy on a daily basis. While Buffet may have been exaggerating, his exaggeration makes his point.**

**For those of us who own stocks for the purpose of creating wealth, times like the current one can certainly be trying. As the media continues its daily reporting of bad news and as investment statements continually show losses, investors' minds become increasingly confused and concerned. Owning stocks while it appears the world is burning is not for the faint of heart. But it is a favorable method for creating and preserving wealth, especially now.**

**Over the last eighteen months or so, investors have faced historical headwinds. Rarely does a day go by that we don't hear about another financial institution either falling by the wayside or being propped up by the government to survive (perhaps) another day.**

**As we are all too aware, home foreclosures continue to soar while home prices continue to decrease, the unemployment rate is increasing, the cost of living continues to pinch our pocketbooks, and consumer confidence is declining. Why would anyone want to be invested in times such as these?**

Our answer is simple and timeless: because the stock market is a forward-looking market, not one that acts according to what's in its rearview mirror. There is no doubt we are in extremely difficult and tricky economic times and the current market reflects this fact. However, the more important fact is actually an unknowable until after the fact: when do the bad times end?

Since no one we've met has a working crystal ball, we place no weight on the talking heads of Wall Street. For some of us, they are good for entertainment but for those of us seeking actionable intelligence, we know the difference between entertainment and intelligence.

So what is some actionable intelligence? Well, we like to share this fact that may capture your attention: the Dow Jones Industrial Average was at 11,497 at the end of December, 1999. As of the end of August 2008, the Dow closed at 11,326, 171 points below its close from over 7 ½ years ago!

To be able to buy the Dow Jones Industrial Average at a price below its price of nearly a decade ago seems too good to be true. Yet, the average investor sees things differently. In the upside-down psychological world of investing, when prices go down, it is not viewed as a bargain to be taken advantage of. This fact explains 99% of the reason why individual investors underperform professional investors or even indexes. Buying high and selling low guarantees failure.

Further actionable intelligence can be found during this near decade of lost growth. For the same investment period as mentioned above, the Vanguard S&P 500 Fund paid over \$15 in dividends per share. It is the power of these dividends, ideally being reinvested, that is a key driver of wealth growth.

While these two facts represent a mere fraction of factors we review in making investment decisions, the only fact that truly matters is that the stock and bond marketplaces, short of niche markets such as real estate, commodities, etc., are two areas that provide the opportunity to generate and protect wealth over time.

On another topic, this last year plus in the stock and bond markets has been one for the record books. Unfortunately, most of those records have been achieved on the negative side! However, this horrific market environment has once again proven the validity of the process that FFA uses to manage investment portfolios.

This process, known as Modern Portfolio Theory (MPT), won a Nobel award for its ingenuity. For us to summarize a Nobel award-winning concept into a few sentences discredits the concept...but here goes anyways! MPT basically builds on the concept of diversification which is simply not putting all of your financial “eggs” in one basket. MPT incorporates as its Holy Grail the concept of asset allocation. Asset allocation means spreading your investment dollars over various asset types such as CDs, money markets, stocks, bonds, international holdings, etc.

With asset allocation, you want certain investments to zig while others zag. In the current marketplace, while stocks have been punished, bonds have been rewarded. With proper asset allocation, you sacrifice the opportunity for top-digit returns for the comfort of having a cushion under your losses. Asset allocation in this current bear market has helped many investors avoid financial devastation.

To conclude, we are no more fortune tellers than the talking heads are. We do however have years of experience doing what we do. It is entirely possible that stock prices will continue their decline and remain down for a lengthy period. Likewise, it is entirely possible for the opposite to happen.

The ultimate question here is: would you rather be in the stock market when it goes down or out of the market when it goes up? History shows, time and time again, that being out of the market when it goes up impedes the opportunity for wealth creation far more significantly than being in the market when it goes down.

One more fact that may prove helpful: over the last 60 years, stocks have gained an average of 74% in the three years following recessions. It is these significant short-term gains that we buy and hold investors get as our reward for holding on through stormy times like we are experiencing currently.

As always, we thank you for your trust, your confidence, and your continued patience as we weather these difficult economic and market times together.

Best Regards,

Berthann & Craig