

## Merrill and Lehman Who?

9-15-08

Less than a week ago, we wrote a commentary titled “Fannie and Freddie Who?” Since the title seemed to work and our creative juices are being strained by the current market, we have simply kept the same title but changed the names of the victims. Our suspicion is this won’t be the last time we take this shortcut.

For independent advisors such as FFA, it is difficult to shed too many tears over the demise of Wall Street firms such as Merrill Lynch and Lehman Brothers. Once upon a time, our parents and perhaps life experience taught us that “if you play with fire, you will get burned.” Unfortunately, the executives of these two firms clearly did not learn their lesson. And now the employees and investors in these two firms have and will pay the price.

To be fair, “Mother Merrill” as she is known to those who know her best, did not file for bankruptcy as did Lehman, a 158-year old Wall Street icon. Merrill simply allowed itself to be rescued by Bank of America, pending regulatory approval. Certainly, the terrain of Wall Street has permanently changed.

So, the most pressing question is: how does this affect our investment portfolios? The answer, as always, must be broken into short-term and long-term. In the short-term, as evidenced by today’s 504 point (4.4%) decline in the Dow Jones Industrial Average, the impact is painful on the stock side of the ledger. However, on the bond side, the short-term impact is positive as evidenced by today’s gains in almost every bond index.

In the long-term, we see these events as positive. As we have stated time and time again, our capitalist society “giveth and taketh” as part of its natural order.

Lehman Brothers and Merrill Lynch both dove headfirst into the subprime mortgage feeding frenzy and both got burned by the fire by which they became intoxicated. Perhaps the executives of both firms should have listened to their own in-house advisors' advice to clients: investing too much in one asset class is akin to gambling and anyone who knows gambling knows that the odds are seriously stacked for the house. In this case, the gamblers lost and the employees and investors will again pay the price.

For us, the Main Street investor, our diversified portfolios by definition avoid the gambling that is the common denominator in all of the firms that now are named on the Wall Street headstone. Yes, our stock mutual funds have suffered due to the subprime mess. While we have great confidence in the quality of our investment holdings, the unfortunate truth is while a rising tide lifts all ships, it also is true that a receding tide lowers all ships. The tide has been receding for some time now and is taking the vast majority of stocks with it.

However, our bonds have been performing exactly as expected, providing positive returns while stocks sink. During these historically turbulent times, the "flight to quality" that has been seen in similar crisis has proven true once again. Investors who fear stocks rush to high-quality bonds, thus creating a buying frenzy and driving the price of bonds up. For example, over the last year, the Dow Jones has dropped by 16% while the Morningstar Core Bond Index has gained over 8%.

It is quite obvious that the subprime contagion has not completed its deadly path of destruction. As we write this commentary, AIG is the next big name with a bull's-eye on its forehead. Through it all, we remain steadfast in our belief that what happens today and tomorrow has minimal impact on our investment results ten and twenty years down the road.

Being a buy and hold investor in turbulent times is a difficult undertaking. For over a year now, we have been counseling those who will listen to stay true to our investment process. With the ever-evolving tsunami of ugly financial news enveloping us, to hold still and do nothing seems counterintuitive. Yet, it is just this patience that brings the ultimate reward.

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**

**P.S. As this evening's news and the morning papers are surely promoting the "plunge" in stock markets, we would like to add some facts to try to cut through the media fog.**

**In October of 1987, the Dow Jones Industrial Average dropped 508 points. This resulted in the largest one-day drop in the history of the Dow. The index on that day dropped 22.6%. Today, the Dow Jones Industrial Average dropped 504 points. Yet, due to the level of the index, the percentage drop was a more palatable 4.4%.**

**In other words, if you had \$100,000 invested in the Dow on October 19, 1987, your investment at the end of the day was worth \$77,400. If you had \$100,000 invested in the Dow today, your investment at the end of the day was worth \$95,600.**

**While having an investment drop by 4.4% is not a pleasant event, we are urging all to view the media's response in the appropriate context. We believe the reality is that today was a significant day; however, one that will have minimal impact on our long-term investment objectives.**