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Advocates for financial peace of mind

Of Democracy and Markets

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Last week, we mentioned we would offer comments "when there is some certainty" as to the outcome and details of the bailout package. Well, plenty of details have been disclosed; unfortunately, we've not seen anything of certainty yet that we can sink our teeth into. Washington has not put its best face forward this week; as Winston Churchill once profoundly stated, "Democracy's the worst form of government except for all the others."

We believe the bailout (and don't let the politicians pull a fast one, this is plain and simple a bailout in its truest form) will happen; the devil is in the details. For those details, we wait and watch. Here's what we know as of this writing:

We know that the stock and bond (credit) markets are waiting with palpable angst. Each player in the game of Wall Street either benefits greatly or loses magnificently based on the outcome of this plan. Theoretically, if Wall Street benefits, Main Street (us) benefits. An inarguable fact is the market hates uncertainty and there remains plenty of that. Another inarguable fact is Wall Street always benefits more than Main Street; don't let anyone fool you into believing otherwise.

We know that the American investor (us) is increasingly frustrated with the seemingly never-ending drop in investment account values. A look at FFA's average investment account shows losses in most asset classes. Asset allocation has proven its mettle by preventing the significant losses we read about. That being said, the stock portions of our investment accounts have taken a drubbing with no end in sight until our politicians come to agreement.

We know that the unprecedented consolidation of the financial services industry will continue. This week, Washington Mutual became the most recent victim with talk of Wachovia being next in line. Regardless, more consolidation will follow. In 2008 alone, we have seen the following institutions go under, be nationalized, or be merged: Bear Stearns, Lehman Brothers, Merrill Lynch, IndyMac, Fannie Mae, Freddie Mac, AIG, and Washington Mutual. We have seen Morgan Stanley and Goldman Sachs become banks. Our instincts tell us there is plenty more to come.

So how does all of this matter? Perhaps a review of history is in order. We are currently in a stock bear market that began in early October of 2007. The S&P 500 Index (a measure of 500 of the largest U.S. public corporations) is down roughly 20% over the last 12 months and 16% year-to-date. The average bear market (a drop of 20% or greater) since 1950 shows the average decline in the nine bear markets that have occurred to be 32%. Further, the average length of these bear markets is 14 months; currently, we are in the 12th month of this most recent bear market.

In our opinion, the more important history lesson to focus on is this: since 1950, the market has dropped in 12 (20%) of the calendar years. For the remaining 46 years (80%), the market has increased. Further, the average return in stocks six months after the end of the bear market is 21%.

Now, we recognize that none of these factoids tell you what to do or when to do it. However, as Harry Truman so aptly stated, "the only thing new in the world is the history you don't know." While all bear markets carry unique characteristics, one common element in all of them is the emotional roller coaster ride of the stock market investor.

While we cannot control nor know when this bear market will end, we feel comfortable in stating unequivocally that "this too shall pass." We have spent weeks reaching out to clients and associates, always counseling to "control what you can control." You can control your emotions and you can control your investment behavior. You cannot control the next up or down move in the stock market, nor can you (or FFA) predict where the market is headed tomorrow, next week, next month, or even next year.

However, we at FFA are steeped in economics and history lessons and stand firm in our belief that capitalism, while bruised, remains the foundation of our society and with capitalism comes business cycles. We are in the throes of a classic business cycle, with our belief that we are ever closer to the trough (bottom) of the cycle. (We are certainly cognizant of the common mantra of "this time it is different." While we agree there are <u>differences</u> in this burst bubble due to the volume of American households impacted by it, we disagree that these differences mean that, in its entirety, "this time is different.") The significant unknown is how long this trough will last. The good news is the stock market typically responds quickly and positively prior to the trough ending.

Several points in the conclusion of our previous commentary bear repeating. First, if you find yourself losing sleep over your investments, please contact us. While we may believe no changes need to be made, perhaps your stomach tells you otherwise. At minimum, it never hurts to vent and have a sounding board.

Second, as we continually urge, please try to view the media's coverage of the "End of the World 2008" with a skeptical eye. This is not a time to allow the media to stir your emotions; successful investors require intellect, not emotion.

Finally, please know that we are here to help you accomplish your financial goals. While you may disagree with some (or all?) of our views, we hope you can agree that your goals have not changed. The unique plans we have put in place for each of FFA's clients have not changed. While our strategies to accomplish these goals may demand tweaks, this is the nature of the beast.

As always, thank you for your continued trust during these stressful times.

Best Regards,

Berthann & Craig