

What's Next in the Financial Markets?

October 9, 2008

There is no sugar coating it, the financial markets over the past year, and in particular the last month have been awful. Using the S&P 500 as the benchmark, the stock market is down approximately 37% from October 9, 2007 to October 8, 2008. A good portion of this drop (almost 19%) has occurred in the past month. With the above acknowledged, as investors we need to focus on what's next. We at Advised Assets Group, LLC (AAG), have prepared the following answers to address some of the questions being asked regarding recent events and what actions, if any, participants might consider at this point.

Q. Can you put the current bear market in some historical context?

There have been 10 previous post-WWII bear markets, defined as declines of at least 20 percent or more in a 12 month period in the S&P 500 stock index. The range of declines have been from 21% to 46% with the average decline being 31.5%. The bear markets of 1973-74 and 2000-02 had declines of 46%. So, by historical standards, the 36% decline we have seen as of October 8, 2008 is slightly above the average decline and approaching the largest declines we have seen over the past 60 years.

Q. What has caused all this turmoil?

In the words of Treasury Secretary Paulson from a few weeks ago, "the underlying weakness in our financial system today is the illiquid mortgage assets that have lost value as the housing correction has proceeded."¹ What has accelerated the decline in recent weeks is the usual pendulum we often see in the financial markets over time, which is investor emotions swinging from greed to fear. Without a doubt, some investors have become very risk adverse and don't want to invest in anything other than what they perceive as the most "safe" investments.

Q. With all the turmoil, does AAG have an opinion as to when the stock market may rebound?

Picking a market bottom is extremely difficult to do and very few investors can do so consistently. We would only observe that historically the stock market often rebounds sharply from bear markets. Looking back, some of the best times to be in the stock market have been at the point of maximum pessimism. It's still too early to tell if we have reached that point as of yet, but it is something that investors should keep in mind.

Q. Do you have any other observations regarding how I should invest my money?

While everyone's situation is different, we do advocate a long term view of investing and recommend investors stay well diversified and establish an asset allocation strategy that is appropriate to their individual circumstances. We also suggest periodic rebalancing of your retirement assets in order to buy securities that are now less expensive and sell securities that have risen in value. Generally speaking, emotions and overreactions to current events usually have a negative impact on the long-term health of your portfolio. To illustrate, industry researcher DALBAR has studied the effects of frequent buying and selling of mutual funds investors and has found that over the past 20 years frequent traders earned less than $\frac{1}{2}$ the return of the S&P 500.²

¹ Source: U.S. Treasury Press Release, hp-1149 , Sept. 19, 2008

² Source: DALMAR, Inc Quantitative Analysis of Investor behavior, 2008

Information derived from a variety of financial publications and economic reporting companies, including the Wall Street Journal, Moody's, S&P, etc.

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