

Market Commentary

Unsettling Times

It's easy in times like these to think things will never get better.

We thought the first quarter of the year was ugly and were encouraged as the stock market bounced back in April. Suffice it to say our joy was short-lived as the market declined in both May and June. There's no way to put a pretty face on the numbers. The Standard & Poor's 500 is down about 12% for the year through June 30.

It's easy in times like these to think things will never get better. Monthly statements show declines in account values. The news is bleak and one tends to feed on the other. How is one to find anything positive?

The first thing to do is to start with perspective and look at the logic of what is happening. The problems confronting the market are clear: continued declines in real estate values, more write-offs by major financial institutions, record high oil prices with predictions they will go even higher, and not surprisingly, dismal numbers on consumer confidence. A few comments:

Real estate: It wasn't too long ago that people were saying real estate was a sure thing. It had always gone up, hadn't it? Well, so much for that sure thing. However, the fact that it isn't a sure thing doesn't mean it will go down indefinitely. We are now seeing the correction when asset values get out of whack and a bubble is created (remember the NASDAQ at 5000 in March of 2000?). At some point real estate values will get back to a supply and demand equilibrium point, pricing will stabilize and the seeds of a future bubble will be born.

Financial institution write-offs: It is true that banks created a lot of securities with dubious value on which rating agencies haphazardly assigned AAA ratings. It's also true that these securities were tied to mortgages and that as the real estate market declined and as foreclosures increased their value was impaired. However, it's also true that even now the real value of these securities isn't clear, and we think there's a reasonable possibility some of the write-offs will prove to be excessive and reappear in the future as profits when written-up.

Oil: With the price of oil at about \$140 per barrel and predictions aplenty about it continuing higher, it's hard not to be concerned. However, you do have to ask if this really makes sense. Less than six months ago oil was less than \$100 per barrel.

However, if history is any guide (and we think it is), this is likely just another part of the normal cycle of markets. It's certainly painful and no fun.

What's changed? Yes, the dollar is slightly weaker and oil is denominated in dollars. Yes, there's unrest in many of the places which produce the bulk of the world's oil, but that's been the case for decades. What's different now is that oil has become an investment for institutions which have no interest whatsoever in taking physical delivery of the oil. They are financial people and not oil people. In addition, as the price goes up market "experts" are predicting it will go even higher. When we hear this it reminds us of the early 1980's when the predecessors of the current experts were predicting \$80 per barrel oil when it was \$40. Oil subsequently hit \$10 per barrel within about 20 years and didn't see \$80 until about a year ago. It also reminds us of the prediction that Amazon.com would hit \$500 in the late 1990's. The person who predicted that ended up being fairly well discredited when the stock did nothing of the sort. We're not discounting the geopolitical problems which make energy availability a major issue. We just think the current price doesn't necessarily reflect underlying fundamentals.

Finally, there is the issue of perspective and the ups and downs of markets. We don't know when the current selling will run its course or when the next upturn will start. However, if history is any guide (and we think it is), this is likely just another part of the normal cycle of markets. It's certainly painful and no fun. As hard as it is, it is important to take a long term perspective and view situations like this within the appropriate context.

We know it's difficult to watch what's going on and encourage you to get in touch with us to discuss your concerns. We try to be proactive in this regard, but also want our clients to contact us if we have not adequately anticipated such concerns.

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