

# Weekly Commentary

## February 9, 2009

### The Markets

We've moved from "drill, baby, drill" to "spend, baby, spend."

As consumers have reduced their spending, the government is stepping in to fill the breach. The idea is that when the economy experiences one of its periodic contractions, it's the government's job to step up to the plate and become the spender of last resort. By replacing consumer spending with government spending, the recession should be shorter and shallower, or so the theory goes.

This theory is based on Keynesian Economics. Keynesian Economics was named after John Maynard Keynes, who was one of the most influential economists of the 20<sup>th</sup> century. His popularity grew enormously starting around World War II, which was shortly after the publication of his masterpiece, *General Theory of Employment, Interest and Money*, in 1936. Keynes argued that it was appropriate for governments to spend money and run big deficits during recessions (and depressions) in order to avert a potentially bigger problem in the absence of big government spending.

Today, many of our elected government officials are invoking Keynesian Economics as justification for the current Congressional stimulus bill. Reasonable people can disagree on whether or not the current stimulus bill is the right medicine in the right dosage, and experts still debate whether Keynesian Economics makes sense. What's sorely missing in this entire debate, though, is how do we dig ourselves out of the big deficit hole that we're creating? Are we simply passing the buck to our children and grandchildren?

The second part of Keynesian Economics is that the government should run surpluses during boom times to refill the hole dug during recessionary periods. That sounds good in theory, but, in reality, our government has run a surplus only six times in the past 50 years, according to the Federal Reserve Bank of St. Louis. With a potential trillion dollar annual deficit coming this year, does anyone really think that our country will be running a profit anytime soon? Perhaps the people on Wall Street do as investors sent the S&P 500 index up more than 5% last week in anticipation of passing the stimulus bill.

It's nice to see that even in these trying economic times, investors can still find a ray of hope.

Returns through 2/6/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	3.5	-5.7	-32.0	-8.5	-4.8	-1.1
NASDAQ Composite	7.8	0.9	-30.9	-11.0	-5.1	-4.0
Standard & Poor's 500	5.2	-3.8	-34.8	-11.8	-5.3	-3.5

Sources: Yahoo! Finance, Barron's. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. Three-, Five-, and 10-year returns are annualized. Assumes dividends are not reinvested.

**THERE IS NO SHORTAGE OF METRICS** that we can analyze to help us determine if the stock market is undervalued, fairly valued, or overvalued. One of the more popular metrics that's making the rounds these days is a chart, which shows the total market value of U.S. stocks as a

percentage of Gross National Product (GNP). In March 2000, this ratio peaked at 190%, according to a February 4, 2009, *Fortune Magazine* article. And, what a peak it was. Between 1924 and 2000, that ratio had never exceeded 100%. As the ratio rises above historical norms, it may signal the market is overvalued. Truly, in March 2000, we were in uncharted waters.

In late 2001, super investor Warren Buffett wrote an article in *Fortune Magazine* in which he referred to this market value to GNP ratio as “probably the best single measure of where valuations stand at any given moment.” At that time, the ratio had fallen from the peak of 190% to 133% – still quite high by historical standards.

Buffett went on to say that, “If the percentage relationship falls to the 70% or 80% area, buying stocks is likely to work very well for you.” Well, guess what? In late January, that metric fell to 75% – right smack in the middle of Buffett’s range. And, as if on cue, the S&P 500 index rallied a whopping 5.2% in the first week of February. How prescient!

Of course, one metric used in isolation is a dangerous way to try to make a profit in the stock market. There are many crosscurrents in our global economy that simply cannot be captured by one ratio. However, this ratio may suggest that valuations are nearing a point where patient investors with a long-term focus may want to consider investing.

### **Weekly Focus – Want to Improve Your Mood?**

If you’re having a bad day, here’s a simple remedy – think fast. Researchers at Princeton and Harvard discovered that accelerated thinking could improve your mood, according to an article in *Scientific American Mind*. Thinking fast made the study participants, “feel more elated, creative and, to a lesser degree, energetic and powerful.”

So, if you want to feel better, try to whip through an easy crossword puzzle, watch a funny show on fast forward, or brainstorm quickly about an idea. Ah, if it were only that easy!

Best regards,

***Jim***

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\* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

\* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

\* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

\* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

\* Consult your financial professional before making any investment decision.

\* You cannot invest directly in an index.

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