Weekly Commentary
June 8, 2009

The Markets

This week marks the two-year anniversary of the financial meltdown. What lessons have we learned?

On June 12, 2007, news broke that a 10-month old Bear Stearns hedge fund that speculated in mortgage-backed securities was melting down. The fund used leverage and bet heavily on bonds tied to subprime mortgages. As the market for subprime mortgages began to implode in early 2007, so did the Bear Stearns fund. This was the first major piece of information that all was not well in the land of finance, and, of course, you know what happened over the next two years.

Interestingly, this news made major headlines at the time, yet the stock market continued to rise for four more months until the S&P 500 index hit its all-time high on October 9, 2007.

Though the history books are still in process, here are a few meltdown lessons worth contemplating:

- Market meltdowns don't happen all of a sudden – they leave clues. But, being able to accurately decipher those clues is very difficult.
- Stock prices can rise much further and much longer than you ever expect.
- Stock prices can fall much further and much longer than you ever expect.
- When investors panic, fundamentals go out the window and securities may drop to levels that, in hindsight, appear to be ridiculously low.
- When prices get ridiculously low, they can soar very quickly on a snapback rebound. For example, witness the nearly 40% rise in the S&P 500 index in the past three months.
- The unimaginable can happen. For example, GM and Chrysler are in bankruptcy, Lehman Brothers and Bear Stearns are gone, the government owns AIG, Fannie and Freddie, and the government has spent trillions of dollars propping up the economy and the financial system.
- No matter how dark and desperate it seems in the financial markets, the sun will still rise in the east, children will play in the park, and life will go on.

As George Santayana wrote, "Those who do not learn from history are doomed to repeat it." We realize that history does not repeat itself exactly, but it is close enough that we do all we can to learn from it.

Data as of 6/5/09	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Standard & Poor's 500 (Domestic Stocks)	2.3%	4.1%	-30.9%	-9.4%	-3.8%	-3.4%
DJ Global ex US (Foreign Stocks)	0.9	15.9	-36.1	-7.9	2.5	1.0
10-year Treasury Note (Yield Only)	3.9	N/A	4.0	5.0	4.8	5.8
Gold (per ounce)	-1.4	10.6	9.5	14.4	19.9	13.7
DJ/AIG Commodity Index	1.7	8.4	-41.6	-10.6	-3.0	4.7
DJ Equity All REIT TR Index	4.3	-4.5	-46.0	-15.0	-0.5	N/A

Notes: S&P 500, DJ Global ex US, Gold, DJ/AIG Commodity Index returns exclude reinvested dividends (gold does not pay a dividend) and the three-, five-, and 10-year returns are annualized; the DJ Equity All REIT TR Index does include reinvested dividends and the three-, five-, and 10-year returns are annualized; and the 10-year Treasury Note is simply the yield at the close of the day on each of the historical time periods.
Sources: Yahoo! Finance, Barron's, djindexes.com, London Bullion Market Association.
Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. N/A means not available.

SINCE WE ARE TALKING ABOUT HISTORY, let's go back to January 2008. If you recall, the economy was doing fine, the stock market was just coming off all-time record highs, and consumers were still spending freely. Few people had any inkling of what would transpire over the next 18 months… except for Gary Shilling, a longtime Wall Street economist and part-time beekeeper. In January 2008, Shilling recommended the following 13 "investment strategies" in his subscription-based newsletter *Insights* as reported on May 31, 2009, in *New York Magazine*:

1. Sell or sell short homebuilder stocks and bonds.
2. If you plan to sell your home, second home, or investment houses anytime soon, do so yesterday.
3. Sell short subprime mortgages.
4. Sell or sell short housing-related stocks.
5. Sell or sell short consumer discretionary-spending companies.
6. Sell low-grade fixed-income securities.
7. Sell or avoid most commercial real estate.
8. Short commodities.
9. Sell or sell short emerging-market equities.
10. Sell emerging country bonds.
11. Buy the dollar before long.
12. Sell or sell short U.S. stocks in general.
13. Buy long Treasury bonds.

Amazingly, Shilling was 13 for 13. So what is he thinking now? Here are a few of his current thoughts according to the *New York Magazine* article, a recent interview with Bloomberg and an article in *The Globe and Mail*.

- Consumers will start saving more and spending less, which will slow economic growth over the next 5-10 years.
- Government involvement will slow us down further because of inefficiencies and protectionism.
- The recession will last another year.
- Housing prices will continue to drop.
- Loan demand will be weak and lenders will be tight.
- The biggest risk is deflation, not inflation.

Shilling was right back in January 2008 and it's possible he could be right again this year. However, while it's worth listening to various points of view, we don't blindly follow any market forecaster because you never know ahead of time which of them will be accurate or when their forecasting skill will expire. Instead, we research, we monitor, and we make adjustments along the way. Ultimately, we use multiple sources, including our own experience, to do the best job we possibly can for you.

Weekly Focus – Think About It

"Fear not for the future, weep not for the past."
--Percy Bysshe Shelley

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.

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