

Weekly Commentary December 8, 2008

The Markets

Ugly headlines sometimes translate into positive results in the stock market.

Last Friday morning's headline economic number was the November unemployment report. In a word, it was "ugly." The Labor Department said U.S. employers cut 533,000 jobs from payrolls last month. To compound the dreary news, the September and October job loss numbers were revised to reflect significantly more job losses than originally reported. So, how did the stock market respond? It took a relatively mild dip as the market opened, but then it rallied near the close and the Dow Jones Industrial Average ended the day with a healthy 3% gain, although it still lost a couple percent for the week.

While the headline number was bad, we did a little more digging and concluded that it wasn't quite as weak as it first appeared. Here's what we dug up:

The loss of 533,000 jobs in November was the sixth largest monthly decline on record and the largest decline since December 1974, according to Bespoke Investment Group. However, when we measure the number of jobs lost as a percent of the workforce, it comes in as only the 41st worst monthly job loss on record. For example, back in December 1974, the economy lost 602,000 jobs out of a total workforce of 77.7 million people. That translates to a 0.78% loss of jobs in one month (602,000/77.7 million). By contrast, the 533,000 jobs lost last month were out of a workforce of 136.2 million people. That translates to a much lower 0.39% loss of jobs in one month (533,000/136.2 million). So, yes, the November job loss number was disappointing, but put in context, it's not nearly as bad – on a percentage basis – as the headline would suggest.

The takeaway is that dramatic headlines may be deceiving. A little more work may reveal a truth that some investors miss and that truth might be part of the difference between a successful investor and an unsuccessful one.

And, by the way, in the 12 months following the December 1974 loss of 602,000 jobs (January – December 1975), the S&P 500 index rose 31% excluding reinvested dividends, according to data from Yahoo! Finance.

Returns through 12/5/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-2.2	-34.9	-36.6	-7.3	-2.6	-0.5
NASDAQ Composite	-1.7	-43.1	-44.2	-12.6	-4.9	-3.0
Standard & Poor's 500	-2.3	-40.3	-41.8	-11.5	-3.8	-3.0

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.

“IRRATIONAL EXUBERANCE” works in reverse, too.

Twelve years ago, on December 5, 1996, Federal Reserve chairman Alan Greenspan gave a lecture at The American Enterprise Institute for Public Policy Research. During an otherwise dry speech, Greenspan uttered the following sentence,

“But, how do we know when irrational exuberance has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade?”

Some investors took his “irrational exuberance” phrase as a warning that perhaps stocks prices had become a little frothy. Backing up that possibility was the fact that for the 12 years prior to December 5, 1996, the S&P 500 index had risen a very healthy 359%, excluding reinvested dividends, according to data from Yahoo! Finance.

But, human nature being what it is, Greenspan’s comment was quickly brushed aside and the market roared ahead anyway. It didn’t stop until the S&P 500 index reached 1,527 in March 2000, a full 105% higher than when Greenspan made his now famous comment. In hindsight, it appears that “irrational exuberance” did indeed take place, since the S&P 500 proceeded to drop about 50% between March 2000 and October 2002, according to data from Yahoo! Finance.

What we may be seeing now is the inverse of irrational exuberance. Let’s call it “irrational gloom.” As of last Friday, this gloom has helped propel the S&P 500 index to a 44% decline from its October 9, 2007, all-time high, according to data from Yahoo! Finance. Prophetically, in the 12 years between Greenspan’s comment on December 5, 1996 and December 5, 2008, the S&P 500 index rose a total of only 18%, excluding reinvested dividends, according to data from Yahoo! Finance. That’s a meager average annual return of 1.4%.

Just like the market kept surging higher for about three years after Greenspan’s comment 12 years ago, this market could go lower even though “irrational gloom” may have set in. That’s not a prediction; it’s an observation that humans are – surprise, surprise – emotional creatures! We sometimes let emotions get in the way of good judgment. The extreme volatility we’ve seen in the markets the last few months may be the result of investors’ emotions overwhelming their rationale thinking.

So, what’s an investor to do? Well, the first step is to admit that emotions may cloud an investor’s judgment. That step alone may help you be a better investor. As your advisor, we try to keep our emotions in check, while seeking an advantage on your behalf from other investors who let their emotions get the best of them.

Weekly Focus – Think About It

“He who knows others is wise. He who knows himself is enlightened.”

--Lao Tzu

Best regards,

Jim

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* 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.

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