

## Weekly Commentary December 15, 2008

### The Markets

The following comment might shock you, so prepare yourself. Here it is... last Monday's closing price on the S&P 500 index confirmed that we have been in a new bull market since November 20th.

Yes, it seems rather ludicrous to say we're now in a bull market since the S&P 500 index is still down about 40% this year. But, according to the standard definition of a bull market as reported by Bloomberg, the bull is alive. The bull is here because the S&P 500 closed last Monday about 21% above its November 20th closing low of 752. That meets the definition of a bull market, which is a 20% rise from a previous 20% or greater decline. The bear market we just exited, which lasted from October 9, 2007 to November 20, 2008, drove the S&P 500 down 51.9%, which is its third worst decline on record without an intervening 20% increase, according to Bespoke Investment Group.

Semantics aside, we're not kidding ourselves into thinking that all is now well in the financial markets. Statisticians and market technicians may have fun playing with these numbers, but in the real world of managing money, we know that bull and bear markets don't neatly conform to standard definitions.

Clearly, even within the context of a negative market environment, we may see significant rallies. These rallies could simply be "head fakes," or bull runs within an ongoing bear market. For example, during the Great Depression between 1929 and 1932, the Dow Jones Industrial Average experienced nine bear markets and eight bull markets, according to Bespoke Investment Group. Each one lasted an average of just 105 days. Even though there were eight bull markets during this period, overall, the Dow dropped dramatically between 1929 and 1932, so we shouldn't necessarily get too comfortable with the current bull market.

The point of this history lesson is we may experience a series of bull and bear markets within the context of a longer-term "secular" bear market. When we see big rallies, pundits will be quick to say the worst is over and it's time to get aggressive. At some point, they may be right. In the meantime, we want you to be aware that big rallies may be followed by big declines. This yo-yo action can be very frustrating, and while no amount of past performance can guarantee the future actions of the market, it's a plausible scenario as the market and economy painstakingly work through the challenges we face.

Returns through 12/12/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-0.1	-34.9	-35.3	-7.1	-3.0	-0.1
NASDAQ Composite	2.1	-41.9	-41.6	-12.0	-4.6	-2.4
Standard & Poor's 500	0.4	-40.1	-40.1	-11.3	-3.9	-2.6

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.

**HOW MUCH IS ENOUGH?** The new administration is reportedly considering a two-year fiscal stimulus package worth up to \$1 trillion, according to *The Wall Street Journal*. They have to walk a fine line though, because just like households, the government cannot spend beyond its means or else it will face negative consequences.

Since households are not in the mood to spend money, the government is turning into the “spender of last resort.” Political leaders on both sides of the aisle are arguing that it’s the government’s role to step in and prop up the economy if consumers are tapped out. This is not new. Our country has a long history of federal stimulus packages including one earlier this year.

The plan now under consideration is massive in scope. According to the *Journal*, it may include, “Funds for roads, bridges, water systems, school repair, spreading broadband access, promoting health-care information technology, improving energy efficiency in buildings, renewable-energy projects, and assisting struggling state and local governments.” It sure sounds nice, but economically speaking, there’s no free lunch.

Spending of this size has the potential to be both wasteful and excessively inflationary. Imagine if we gave you a budget of \$1 trillion. Do you think you could effectively and efficiently spend it within two years? Okay, it would be fun trying, right!

As it relates to supporting the economy, we don’t know whether \$1 trillion is the right number or not. Keep in mind, the government has already provided hundreds of billions of dollars in various backstops, facilities, bailouts, and guarantees. Combined, we’re talking serious money. Ultimately, this intervention may pose substantial long-term risks to our economy if not handled properly.

- One long-term risk is the possibility of uncontrollable inflation. Currently, few people are worried about inflation because economic growth is weak and commodity prices are plunging. But, with all this stimulus, the possibility exists that the economy could inflate beyond the government’s ability to corral it.
- A second risk is the possibility of an extremely weak dollar. If we print too many dollars and nobody wants to own them, then the value goes down. This would make our exports more competitive (a good thing), but our imports more expensive (a bad thing). It could also lead to a rise in commodity prices, higher inflation, and higher interest rates.
- A third risk is how effective will the government be in extricating itself from the economy after it’s outlived its usefulness. Many people, including some diehard free marketers, are willing to accept some level of government intervention right now to help prevent a devastating economic collapse. However, if things turn around, will the government be able to exit the economy gracefully without causing a relapse?

When the government intervenes in our economy at a level that is way above historical norms, there may be unintended consequences. As an advisor, we can’t control what the government does with all of our tax dollars. However, we can monitor the government’s actions and do our best to try and position you well for whatever unintended consequences may result.

## Weekly Focus – Think About It

“Government’s view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And, if it stops moving, subsidize it.”

--Ronald Reagan

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.

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