

Weekly Commentary December 22, 2008

The Markets

It's "Helicopter Ben" to the rescue.

For people who follow the financial markets, last Tuesday's announcement by the Federal Reserve was a watershed event that historians, pundits, and investors will talk about for years to come. The Fed essentially opened the floodgates to help the economy and signaled more help is on the way. Here are the key points from the Fed's announcement.

- It established a new target range for the federal funds rate of 0 to ¼%—effectively it's as low as it can go.
- It expects to keep the federal funds rate at an exceptionally low rate, "for some time."
- It will use, "All available tools to promote the resumption of sustainable economic growth and to preserve price stability."
- It is evaluating the benefits of purchasing longer-term Treasury securities as a way to lower long-term interest rates.
- Going forward, it will, "Support the functioning of financial markets and stimulate the economy through open market operations and other measures that sustain the size of the Federal Reserve's balance sheet at a high level." Past performance does not guarantee future results.

Money manager Bill Fleckenstein summed it up nicely by saying, "The Fed went for it, corroborating the view that many of us have held for some time: that when push came to shove, the central bank would let nothing stand in the way of printing any amount of money, and monetizing anything required to fend off the ill effects of the collapsing bubble."

Wall Street's reaction to all this was mixed. On the day of the announcement, the Dow Jones Industrial Average soared 359 points. Over the next three days, though, it gave back most of those gains.

For homeowners, the Fed's action was positive. Long-term interest dropped significantly after the announcement and that may translate into lower mortgage rates. If this causes the housing market to perk up, it may give the economy the jolt it needs to begin stabilizing.

You probably remember the old saying, "We're from the government and we're here to help." No doubt about it, the Fed, the Treasury, the White House, and even Congress are now "here to help." The question is, do they know what they're doing?

As James Grant, editor of *Grant's Interest Rate Observer*, so wryly pointed out in a recent *Wall Street Journal* essay, "Prescience is rare enough in the private sector. It is almost unheard of in Washington." Despite this historical lack of foresight, we're all putting faith in the government that they can correctly diagnose our current problems and prescribe the right dose of medicine to

get the economy moving again. So far, the medicine may have moved us out of the emergency room, but we're still in intensive care.

Returns through 12/19/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-0.6	-35.3	-36.2	-7.5	-3.5	-0.5
NASDAQ Composite	1.5	-41.0	-41.9	-11.1	-4.3	-3.1
Standard & Poor's 500	0.9	-39.5	-40.2	-11.0	-4.0	-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.

THE SPEED AT WHICH the economy and the financial markets have moved this year is astonishing. Here's a brief look at some of the most amazing changes.

- The S&P 500 index dropped nearly 47% in just six months between May 20 and November 20, according to data from Yahoo! Finance. By contrast, during the severe 1973 – 1974 bear market, it took the S&P 500 more than one year and eight months to drop that amount (January 11, 1973 to September 27, 1974).
- Crude oil prices started the year at \$95.98 a barrel and just over seven months later, it peaked at \$145.29 per barrel on July 3—a 51% increase, according to data from MSN Money's December 31, 2007 article. This helped stoke fears of runaway inflation. But wait, crude prices then plunged 76% in less than six months between July 3 and December 19. Now the talk is about deflation. Vertigo, anyone?
- The yield on the 10-year Treasury bond dropped from 4.02% on October 14 to 2.07% on December 18, according to data from Yahoo! Finance. That's a 48% decline and nearly two full percentage points in just over two months. By contrast, for the *six years* ending October 14, 2008, the yield on the 10-year bond changed by less than one quarter of one percent, according to Yahoo! Finance data.
- Nonfarm payroll employment rose by 94,000 in November 2007. Just a year later, in November 2008, nonfarm payroll employment *fell* by 533,000, according to the Department of Labor. And sadly, from December 2007—the start of this recession—to November 2008, the number of unemployed persons in the U.S. rose by 2.7 million. This is according to the Bureau of Labor Statistics letter dated December 5, 2008.
- According to a Yahoo Finance article on December 16, 2008, The auto industry, as we all know, is hurting. Parts supplier Johnson Controls issued an outlook on October 14 of this year and forecasted North American auto sales would reach 12.3 million units in 2009. Just two months later, on December 16, they revised their forecast downward to only 9.3 million units. Is it any surprise that two of the Big 3 auto manufacturers are on the brink of bankruptcy?

We're not sharing this information to depress you. We're simply pointing out that changes are happening with lightening speed. So far, many of these changes have been detrimental to people's wealth. But, on the positive side, let's keep in mind that if things turned this quickly on the downside, perhaps they could also turn that quickly on the upside. A return of confidence may be one key to making that happen.

Weekly Focus – Happy Holidays

As we wrap up one year and begin a new one, we wish you and your family peace, health and happiness. It's our privilege to serve you and we look forward to working hard on your behalf in the years to come.

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.

* You cannot invest directly in an index.

* Past performance does not guarantee future results. Due to ongoing market volatility, current performance may be more or less than the results shown in this white paper.

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