Weekly Commentary
February 19, 2008

The Markets

There's not always a direct correlation between what's going on in the economy and what's happening in the stock market.

For example, right now, many people are talking about the U.S. either being in or about to start a recession. Just look at some of the bad news.

- Last week, the Reuters/University of Michigan consumer sentiment index dropped to 69.6, its lowest reading since February 1992, according to Reuters.
- The latest monthly Merrill Lynch survey of fund managers worldwide said, "Fund managers and asset allocators are the most risk averse in more than seven years."
- Fed Chairman Ben Bernanke told the Senate Banking Committee that "The outlook for the economy has worsened recently and that the risks to growth remain to the downside," according to CNN Money.
- Former Fed chief Alan Greenspan added his two cents last week and said, "There's at least a 50% chance the economy will fall into a recession," as reported by CNN Money.
- From a corporate standpoint, General Motors posted a record loss of $38.7 billion for 2007. That was GM's third straight annual loss, according to MarketWatch. Even electronics retailer Best Buy said fewer people are ponying up for tech toys and that their "post-holiday results are not going to be what we originally expected," according to Forbes. This is not a recommendation to either buy or sell those two securities.

With all the bad news that's out there, you'd think our economy was kaput and the stock market would be in tatters. The reality is, the economy appears to have slowed down, it may or may not decline to a recession, and the stock market seems to be holding up reasonably well, all things considered.

We need to keep in mind that the stock market tends to be a forward-looking entity. Most investors realize that recessions tend to be temporary and that economic activity ebbs and flows. However, investors with a short time horizon may throw in the towel and temporarily depress stock prices. As famed investor Peter Lynch wrote in *Worth* magazine, "Far more money has been lost by investors in preparing for corrections, or anticipating corrections, than has been lost in the corrections themselves."

Patient investors may use dips in the market to try to snap up bargains. At the end of the day, patient, but opportunistic, investors may beat impatient, panicky investors. One of the keys is to try to wait for the "fat pitches" and, as your advisor, we're always on the lookout for them.

Returns through 2/15/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	1.4	-6.9	-3.3	4.4	9.0	3.9
Nasdaq Composite	0.7	-12.5	-7.0	3.6	11.5	3.1
Standard & Poor's 500	1.4	-8.1	-7.3	3.7	9.7	2.8

Sources: Yahoo! Finance, Barron's. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. Three-, 5-, and 10-year returns are annualized. Assumes dividends are not reinvested.

MAYBE YOU'VE WATCHED THE "MOMENT OF TRUTH" on TV where contestants are asked embarrassing questions and a lie detector determines whether they respond truthfully. Now, researchers say they have a way to test the honesty of companies. Preliminary findings from research conducted by Patrick Fan and Greg Jenkins, associate professors of accounting and information systems in the Pamplin College of Business, suggest that text analysis can be used to identify language patterns in management communications that are inconsistent with either the company's financial performance or with the communications of other companies in the same industry. Patterns of inconsistencies in corporate communications may indicate fraud.

For example, a company's financial performance may be similar to that of its competitors, but the language used in an annual report to describe its prospects could be overly optimistic, overly specific, or vague relative to others in the industry. The researchers note that Enron's annual reports from the late 1990s exuded an "unlimited optimism" at a time when other companies were starting to admit struggles. Also, the company's descriptions of related-party transactions were incomplete and overly vague.

Just how valuable might this analysis be? Professor Jenkins notes that a report by Glass Lewis & Co. recently estimated that high-profile frauds resulted in the loss of almost $900 billion in market capitalization from 1997 to 2004.

The professors, experts in auditing and information systems, hope to develop their methodology into a more precise new tool to help auditors and regulators detect fraud. They have received a grant of about $196,000 from PricewaterhouseCoopers for their two-year project, expected to be completed in 2009. They envision their software serving as a decision-support tool that would improve the efficiency of the auditing process, help auditors gain additional sources of evidence, and, ultimately, enable detection of financial fraud. Sounds like a good idea to us.