

## Weekly Commentary March 10, 2008

### The Markets

The American dream of home ownership is causing some people a lot of nightmares.

Stocks took it on the chin again last week as weak housing and credit data helped keep investors in the doldrums. According to data from the Mortgage Bankers Association (MBA) as reported on March 6<sup>th</sup> by MarketWatch.com, “The rate of mortgages entering foreclosure was at its highest level in the history of the MBA's quarterly national delinquency survey and the percent of loans somewhere in the foreclosure process also hit its highest level.” While homeowners are having trouble making payments, so are the mortgage lenders. Various mortgage companies made headlines last week when they were unable to meet margin calls and that spooked Wall Street.

Declining home prices also helped contribute to the fact that, “Last year marked the first time American homeowners, in the aggregate, owned less than half the value of their houses. Their share of home equity -- the market value of a home minus the size of its mortgage -- dropped to 47.9% in the final three months of 2007,” according to data from the Federal Reserve, as reported by *The Wall Street Journal* on March 7<sup>th</sup>. By contrast, home equity was more than 80% in 1945.

The weak housing market is proving painful to the stock market. And while the Federal Reserve is using its various levers to try to pull the industry out of its slump and add liquidity to the credit markets, it may be a long and winding road before we can take a victory lap.

Returns through 3/7/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	-3.0	-10.3	-3.1	2.8	9.0	3.3
NASDAQ Composite	-2.6	-16.6	-7.3	1.9	11.1	2.5
Standard & Poor's 500	-2.8	-11.9	-7.8	1.8	9.3	2.1

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.

**DATELINE MARCH 10, 2000. DO YOU REMEMBER THAT DAY?** It was a giddy time in the stock market as that was the day the NASDAQ Composite Index closed at an all-time record high of 5,048.62, according to Yahoo! Finance. To show you just how euphoric that time was, the NASDAQ Composite Index rose at a phenomenal average annualized rate of 44.5% for the preceding five years ending March 10, 2000, according to data from Yahoo! Finance. But, then the bubble burst and the NASDAQ Composite Index began a severe decline. Now let's fast forward to last Friday, which is eight years later, and we see that the NASDAQ Composite Index is still 56% below its all-time high, according to Yahoo! Finance. Ouch!

Aren't stocks supposed to go up in the long term? Isn't eight years long enough to recover from a bear market? Those are two good questions and we'll try to answer them.

Yes, historically, stocks have risen in the long term in the United States. According to AIM Investments, the S&P 500 Index (generally considered a broad measure of the U.S. stock market) rose at an average annualized rate of 10.4% between 1926 and 2007. While that's the average annual total return over a long period, the actual return in any given year could be much different. **Stock market**

returns are generally quite “lumpy.” For example, the S&P 500 rose 37% in 1995 and declined 26% in 1974, according to AIM Investments.

While the NASDAQ Composite Index is still down 56% from its March 10, 2000, close, the S&P 500 is actually down “only” 7% from its March 10, 2000, close, according to Yahoo! Finance (although the S&P 500 did hit a new all-time high back on October 9, 2007). Why the big gap? Part of the reason is diversification. Even though the NASDAQ Composite Index contains more than 3,000 securities, many of them are technology related, don’t pay dividends and, on average, they are smaller companies compared to the S&P 500 Index.

You see, diversification is not simply achieved by the number of stocks you own, it’s achieved by owning an array of securities with different risk and return profiles that respond differently to economic circumstances. So to answer the first question, yes, stocks have historically gone up, but we need to make sure that we own well diversified portfolios.

Concerning the second question, under “normal” circumstances, we would expect eight years to be long enough to get back to even from a bear market. For example, according to a March 7<sup>th</sup> article by Mark Hulbert at MarketWatch.com, it took about four years for the DJ Wilshire 5000 Index (the broadest index for the U.S. stock market) to reach an all-time high after touching its 2000-2002 bear market low set on October 9, 2002. Hulbert also pointed out that it took only 17 months for the DJ Wilshire 5000 Index to regain its all-time high after the October 1987 stock market crash. So, what’s the problem with the NASDAQ Composite Index? Why is it still so far off its all-time high? In a word – diversification (or more accurately – lack thereof).

Generally speaking, the NASDAQ Composite Index is not a well-diversified, broad-based index. It’s heavily weighted toward technology stocks and many of those stocks are still struggling to regain their former, late 1990s glory days.

The bottom line is diversification is critical to successful investing. But, not just any old diversification; it has to be intelligent diversification with a variety of asset classes that are carefully constructed. The good news about investing today is that we have a broader range of investment vehicles and asset classes to choose from compared to a few years ago. While no guarantee against loss, we try to build intelligent diversification into our clients’ portfolios to help minimize the pain when financial markets are in disarray...as they seem to be now.

## **Weekly Focus – Reach Out and Call Someone**

Okay, do you remember what you were doing on March 7, 1876? Not likely! Well, that was the day 29-year old Alexander Graham Bell received a patent for the telephone. Can you imagine going a day without using the phone? As a random act of kindness, why don’t you pick up the phone today and call someone and let them know how much you appreciate them.

Best regards,

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. .

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