

Weekly Commentary August 4, 2008

The Markets

If you simply look at the trend of our gross domestic product (GDP) over the past three quarters, you might get the impression that the economy is poised for takeoff. But, just like you shouldn't judge the quality of a bottle of wine based on the beauty of its label, you shouldn't trust statistics without looking into the details.

Here's what the GDP trend looks like, according to newly revised data from the Department of Commerce:

<u>Period</u>	<u>GDP Change</u>
Q4 2007	-0.2%
Q1 2008	0.9%
Q2 2008	1.9%

Based on the chart, it looks like the economy was weak in Q4, but has been steadily improving since then. On the surface that's accurate, but let's look under the hood a bit.

The second quarter included \$91 billion of one-time economic stimulus payments that helped boost the consumer spending component of GDP to an annualized growth rate of 1.9%, up from 0.9% in the first quarter, according to *The Wall Street Journal*. Also, the *Journal* noted, "Strong export growth is the biggest factor keeping the economy out of recession." To buttress that point, exports grew 9.2% in the second quarter. But, how long will our strong export growth last? An August 1st *Journal* article said, "Many parts of the world are slowing down themselves as rising prices take a toll on consumers and businesses." If export growth slows, that may have a negative effect on future GDP growth.

Yes, we're pleased to see that the economy grew 1.9% in the second quarter. However, upon further analysis, the number may be a little misleading. Wall Street seemed to agree because on the day the number came out, the Dow Jones Industrial Average dropped 205 points.

Investing is a bit like putting a puzzle together. It takes many pieces to create the whole. In this case, the "under the hood" GDP number is just one of many pieces that help define the state of the economy. We continue to review lots of "pieces" in an effort to do the best job possible for you.

Returns through 8/1/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	-0.4	-14.6	-14.1	2.2	4.4	2.6
NASDAQ Composite	0.0	-12.9	-7.8	1.7	6.1	2.2
Standard & Poor's 500	0.2	-14.2	-12.1	0.7	5.2	1.3

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.

BEAR MARKETS ARE QUITE TRICKY because it's common to see big "up" days in the middle of a major decline. These up days may convince a naïve investor that all is well and they may dive in, only to discover it was a head fake. The financial sector is a good example. Year to date through July 31, the Financial sector was down more than 25%, according to Bespoke Investment Group. However, if you look at the 10 biggest up days in the Financial sector since 1990, seven of them occurred in 2008. That's right. Despite the sector dropping more than 25% this year, it still experienced seven dramatic up days.

The Technology sector experienced the same thing. During the 2000 – 2002 bear market, the Technology sector lost 82% of its value, according to Bespoke. Yet, during that horrible period, the sector experienced nine of its 10 biggest up days since 1990.

Just like the GDP trend discussed above, a big up day in the market makes a good headline, but it may not be the "all clear" signal. Nobody rings a bell at the top of a market and nobody rings one at the bottom. Among other things, it takes hard work, patience, and "emotion management" to succeed as an investor.

YES, OIL COMPANIES DO MAKE A LOT OF MONEY, BUT as investors, we have to keep these profits in proper perspective. Exxon Mobil announced last week that it posted net earnings of \$11.7 billion in the second quarter, according to MarketWatch. That was an all-time U.S. record for quarterly earnings. Ironically, it didn't impress investors because the stock dropped nearly 5% on the day the earnings were announced, according to Associated Press. Investment analysts expected the company to earn even more.

So, what perspective should we be looking at here? Profit margins are a good place to start. If you take Exxon's \$11.7 billion in net profit and divide it by its quarterly revenue of \$138.1 billion, you get a net profit margin of 8.5%. That's solid but unspectacular. By contrast, let's look at The Walt Disney Company. Disney announced last week that third quarter net profit was \$1.3 billion on \$9.2 billion in revenue. Doing the math, that comes out to a net profit margin of 14.1%. As you can see, Disney's profit margin is more than 60% higher than Exxon's, yet how many people in government are talking about a windfall profits tax on Disney?

We're not making this point to defend oil companies. The point we're trying to make is that once again, you have to look under the hood to determine what's really going on. Exxon is a profitable company, but the margins they earn do not appear outrageous – even after considering the fact that oil prices have risen dramatically recently.

Weekly Focus – Sleep On It

If you want to get smarter, don't skimp on your sleep. According to a recent *Scientific American* article, "Sleeping on it" seems to provide the clarity we need to piece together life's puzzles." Apparently, while we're sleeping, our brain is busy processing that day's information so, that when we wakeup, we may have an answer to a problem or we may have new insight on something that's been puzzling us. So, there you have it – permission to sleep in!

Best regards,

The Advocate Group

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.

Securities offered through LPL Financial, Member FINRA/SIPC.

- * 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.
- * To unsubscribe from the Weekly Commentary, please reply to this e-mail with "unsubscribe" in the subject line.