



## THE ADVOCATE GROUP

*A Bridge to Financial Clarity*

### Weekly Commentary October 13, 2008

#### The Markets

“Past performance is no guarantee of future results.”

That’s a phrase you hear often in the securities business, in fact, securities regulators require that disclosure in certain written communication. It’s most common usage is to warn investors that if an investment has performed extremely well in the past, it’s no guarantee that the investment will continue to perform well in the future. Conversely, it could also mean that a poorly performing investment is not guaranteed to continue performing poorly in the future.

Here’s a third way to interpret that statement. The past performance of stock market indicators is no guarantee that those indicators will hold up in the future. What we mean by that is, historically, investment analysts have developed ratios, technical indicators, chart patterns, and various other tools to help them determine if stocks are “properly” valued. These tools help guide investors in making investment decisions. Unfortunately, the swiftness and the degree of this decline are rendering many of these indicators less useful.

With that said, this is no time to throw up your hands and cry “uncle.”

The depth and speed of this worldwide decline, coupled with the seizing up of the credit markets, is unprecedented in our lifetime and it caught many people off guard. For example, here are a few quotes that show how wrong some people in power were:

- On March 28, 2007, Fed Chairman Ben Bernanke told Congress that subprime defaults were “likely to be contained.”
- On June 20, 2007, Treasury Secretary Hank Paulson said that subprime fallout “will not affect the economy overall.”
- On June 27, 2007, Stan O’Neal, then the CEO of Merrill Lynch, called subprime defaults “reasonably well contained.”

Today, there’s no doubt that the situation we’re dealing with is serious and despite their tardiness, government and business leaders clearly understand that. They’re doing what they can to solve this problem as are we. As your advisor, it’s our job to keep digging and keep searching for better ways to manage and protect your investments. When the historical indicators no longer work, then it’s our job to find new ways to analyze the situation and respond as we think appropriate.

Please be assured that we’re not crying uncle. Instead, we realize that it’s times like these that the seeds of opportunity are sown. Major market disruptions as we’re witnessing now may lead to

unprecedented opportunities down the road. We're keeping our eye on that road and doing our best to take advantage of any opportunities we find along the way.

If you have any questions or concerns, please let us know. We are here for you.

Returns through 10/10/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-18.2	-36.3	-40.0	-6.2	-2.7	0.5
NASDAQ Composite	-15.3	-37.8	-41.2	-7.4	-2.9	0.7
Standard & Poor's 500	-18.2	-38.8	-42.4	-8.8	-2.8	-1.0

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.

**WHAT HAS TO HAPPEN** for this market to find a bottom? With an 18% decline in the Dow Jones Industrial Average last week and a 40% decline over the past 12 months, trying to call a bottom in this market has been futile. While nobody can predict exactly when we'll hit bottom, here are a few things to monitor:

- First, a credible government action plan could help put a floor under stock prices. So far, our government's piecemeal approach to this crisis hasn't worked. However, if they're able to get their act together and work in coordination with their G-7 and G-20 counterparts, then we may see some confidence return to the markets and a bottom could begin to form.
- Second, "Bottoms are made when selling becomes exhausted and long-term participants perceive value and lift stocks sharply off their lows," according to Brett Steenbarger, Ph.D. As of last week, we still haven't seen the long-term participants enter the market and lift stocks. Instead, we've seen one down day followed by another. It's been a vicious cycle of selling that feeds on itself. At some point, though, we expect the strong selling pressure to abate and bargain buyers to emerge. Let's hope that happens sooner rather than later.
- Third, the credit markets need to get back to some semblance of normality. Currently, banks are afraid to lend money and this constriction of credit is causing major problems for consumers and businesses. Too much credit and too little credit are both bad things. We need to strike a balance in order for commerce to function. Right now, credit constriction is putting a crimp in commerce.

One way to help determine if the credit freeze is thawing is to look at the "TED spread." This is the difference between 3-month LIBOR (an average of interest rates offered in the London interbank market for 3-month dollar-denominated loans) and the 3-month Treasury bill rate. According to Bespoke Investment Group, "Elevated readings in the indicator indicate an increased level of risk aversion in the market, as investors flock to short term T-bills, which due to their credit quality and short time horizon, are considered risk free, while Eurodollar futures are more representative of the credit quality of corporate borrowers." Historically, the TED spread has stayed below 1/2 of 1%, meaning the LIBOR interest rate has usually been less than 1/2 of 1% higher than the T-bill rate, according to Econbrowser. However, last Friday, the spread was a record 4.6%, according to Bloomberg. This extraordinary reading suggests banks are very leery of lending money and, when they do, they demand a significant premium. This number will likely need to come down dramatically before we see the stock market stabilize.

In summary, keep your seatbelts fastened. There may be more turbulence ahead, but we're doing all we can to get you to your destination as safely as possible.

## **Weekly Focus – Think About It**

“Most of the time common stocks are subject to irrational and excessive price fluctuations in both directions as the consequence of the ingrained tendency of most people to speculate or gamble – i.e., to give way to hope, fear, and greed.” – *Benjamin Graham*

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.

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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.
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