THE ADVOCATE GROUP

A Bridge to Financial Clarity

Weekly Commentary
October 20, 2008

The Markets

High volatility continued last week, but when the closing bell rang on Friday, investors were smiling as the Dow Jones Industrial Average recorded its biggest one-week gain in more than five years, according to *The Wall Street Journal*.

On Monday of last week, the Dow rose a stunning 936 points, but on Wednesday, it took a 733-point dive. And, for good measure, it popped higher by 401 points on Thursday. These dramatic daily swings suggest that investors still lack strong conviction on which direction the market is heading.

The government intervention in the financial markets continued last week and investors were left trying to figure out what it all means. At one end of the spectrum, you have people who are thrilled that the government is stepping in and preventing more firms from going under. At the other end, you have free-market champions who are furious that the government is propping up weak firms that otherwise might fail because of their bad decision-making. If nothing else, these historic times are keeping bloggers and opinion page writers busy arguing their particular point of view.

One surprising piece of news last week was the opinion page article penned by super investor Warren Buffett that was published in the *New York Times*. The normally tight-lipped investor went on the record as saying he was buying stocks last week for his personal portfolio, according to CNBC. Buffett also said, "Fears regarding the long-term prosperity of the nation's many sound companies make no sense. These businesses will indeed suffer earnings hiccups as they always have. But, most major companies will be setting new profit records five, 10, and 20 years from now."

Buffett says one rule dictates his buying: "Be fearful when others are greedy, and be greedy when others are fearful." Right now, with these tremendous daily swings, there appears to be plenty of fear. And, if Buffett is right, then the prices we see today might look pretty attractive five or more years from now.

Returns through 10/17/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	4.8	-33.3	-34.5	-5.1	-1.9	0.4
NASDAQ Composite	3.8	-35.5	-37.2	-6.2	-2.2	0.4
Standard & Poor's 500	4.6	-36.0	-37.3	-7.5	-2.0	-1.2

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 WILL BE THE CLOSING PRICE of the Dow Jones Industrial Average five years from now? While nobody knows the answer to that question with 100% certainty, it is worthwhile to look at several different scenarios. By understanding what might happen, we may be able to put ourselves in a better position to profit from what actually happens. Here are three possible scenarios:

Scenario 1: The stock market is significantly lower five years from now. In order for this to happen, we would likely need a severe and long-lasting recession that borders on a depression. In light of what's happened over the past few months, this is not entirely out of the question; however, we think the likelihood of this happening is small. The U.S. government's massive intervention in the economy and the global response to this crisis will likely prevent this type of complete meltdown.

Scenario 2: The stock market is about even five years from now. This could happen if we have a major recession that puts a multi-year crimp in corporate earnings. This wouldn't be as bad as the meltdown in Scenario 1, but it would probably have to be on par or slightly worse than the early 1980s recession. Even if this were to happen, there could still be some profit-making opportunities in the stock market. For example, between 1929 and 1934 during the depth of the Great Depression, there were 9 bear and 8 bull markets as defined by an increase or decrease of 20% or more in the Dow Jones Industrial Average, according to data from Bespoke Investment Group. So, even though the Dow experienced an overall drop between 1929 and 1934, there were several significant rallies in between that offered potential profit-making opportunities.

Scenario 3: The stock market is higher five years from now. This might be the most likely scenario given the significant drop we've already experienced. Here are several pieces of information that help support the likelihood of this scenario coming to fruition:

- First, as we mentioned earlier, Warren Buffett said he's started to buy stocks for his personal portfolio. That's a comforting sign for many investors.
- Second, noted investment manager John Hussman mentioned in his October 13 market commentary that, "Stocks are now at the same valuations that existed at the 1990 bear market low. Relative to 30-year Treasury yields, the S&P 500 is priced to deliver the highest excess return since the early 1980s." In effect, he seems to suggest that the downside risk from here may be small and that there may be some significant upside available.
- Third, noted investment manager Jeremy Grantham, who is chairman of the $120 billion money management firm GMO, wrote in an October 17 letter to clients, "At under 1,000 on the S&P 500, U.S. stocks are very reasonable buys for brave value managers willing to be early." Grantham had been bearish on the market for many years, so this is a big turnaround for him.
- Fourth, corporate insiders are buying much more stock than they are selling as of October 10, according to Vickers Weekly Insider Report as reported by Mark Hulbert at MarketWatch. This insider buying ratio was the best in nearly 10 years, which is often a bullish sign for future stock prices.

Short of getting a copy today of *The Wall Street Journal* that will be printed five years from now, we know that any forecast about the future is subject to error. With that said, as outlined in Scenario 3, we think there are numerous reasons to be optimistic about the future. That doesn't mean it will all be rosy from here. We'll likely experience more harrowing hiccups, but, eventually, the crisis should pass, the excess should be cleared out, and the market should move higher. Time tends to heal all wounds.

Weekly Focus – Think About It

"Our interviews, experience, and involvement with people at mid-life have led us to believe that nothing is more important to fulfillment in the second half of life than the willingness to 'risk walking new ground.'" -- *Richard Leider and David Shapiro*

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.