



# THE ADVOCATE GROUP

*A Bridge to Financial Clarity*

## Weekly Commentary October 27, 2008

### The Markets

Almost, but not quite.

As we awoke early last Friday morning and turned on our computers, we saw something that doesn't happen very often. Pre-market opening indicators were suggesting a massive drop in the U.S. stock market when trading opened at 9:30 am Eastern time, according to MarketWatch. We already knew that many overseas markets had plummeted since most of them start trading well before the U.S. market opens. Japan's main stock market index, for example, had dropped more than 9% prior to the start of trading in the U.S., according to MarketWatch. With that backdrop, investors nervously awaited the opening bell in New York. As the bell rang that morning, stocks dropped significantly in the first few minutes. But then, something surprising happened—*no panic ensued*. After see-sawing throughout the day, the Dow Jones finished with a disappointing 3.6% loss, but that was greeted with relief by many investors, who feared a much steeper decline.

It's almost become a parlor game now with market pundits trying to call the bottom in the market. Many of them seemed to be waiting for the big washout-type capitulation day that takes the market down by double digits on record volume. Some people thought last Friday would be the day, but it didn't happen.

With so many people looking for a big capitulation day, there's a reasonable chance that it may not happen. According to an October 25 *Wall Street Journal* article, "Bear markets often end not in a crescendo of selling but [in] a cloud of indifference." Ultimately, bear markets may end when stocks get so cheap that buyers step in and start bidding up prices.

Nobody knows whether this bear market will end with a record-breaking capitulation day or end unspectacularly as the selling pressure just peters out. This market has confounded so many "experts" that it's anybody's guess. Instead of worrying about calling a bottom, we're trying to identify where the compelling values are and take advantage of them.

Returns through 10/24/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-5.4	-36.8	-39.3	-6.9	-2.6	-0.1
NASDAQ Composite	-9.3	-41.5	-44.7	-9.8	-3.6	-1.1
Standard & Poor's 500	-6.8	-40.3	-42.9	-9.9	-3.2	-2.0

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.

**ARE HUMAN EMOTIONS PARTLY RESPONSIBLE** for the volatility we're seeing in the financial markets? There's no doubt that volatility is running rampant right now. The VIX, which is a

widely used to measure of market risk often referred to as the “investor fear gauge,” rose to a record high last week, according to Bloomberg. But, is this fear rational? Do the fundamentals of our economy support the worldwide declines we’ve seen in the past month?

Clearly, the U.S. economy and many overseas economies are experiencing a significant slowdown. The ultimate severity of this downturn will not be known for quite some time. However, we do know that the financial markets are reacting violently to what’s happening. Could our emotions be getting in the way of sound investment judgment?

Westcore Funds/Denver Investment Advisers, LLC, developed a chart, which illustrates how volatility in the financial markets may cause us to turn off our rationality switch and replace it with some degree of either fear or greed. Below is a brief summary of what they call *The Cycle of Market Emotions*:

As markets rise, investors’ optimism begins to grow, excitement builds, and making money becomes thrilling. Over a period of time, the bull market finally reaches a crescendo, euphoria and greed set in and unbeknownst to most investors, this is the point of maximum financial risk. In hindsight, this could describe the first quarter of 2000, when the technology bubble reached its zenith. Inevitably, the market starts to drop, anxiety builds, and denial, fear, and desperation set in. Eventually, panic is followed by capitulation as some investors throw in the towel and say “I can’t take this anymore.” Capitulation is followed by despondency and it’s right here where you may find the point of maximum financial opportunity. Depression ensues, but then, when people realize the world is not coming to an end, the markets start to turn up. Hope turns into relief, which then leads to optimism and then the cycle starts all over again.

Since the current bear market is still unfolding, it’s not possible to say where we may be in this cycle. However, it would not be going out on a limb by saying we’re probably at least in the desperation/panic area. If true, we may see more pain before the next gain.

We need to keep in mind that successful investing takes more than just doing good research. It also takes strong emotional control and the ability to swim against the tide at times. By understanding the cycle of market emotions, and not letting fear or greed become dominant, you may be able to better tolerate and may ultimately profit from market fluctuations.

### **Weekly Focus – Can You Solve This Puzzle?**

Study this paragraph and all things in it. What is vitally wrong with it? Actually, nothing in it is wrong, but you must admit that it is most unusual. Don't just zip through it quickly, but study it scrupulously. With luck you should spot what is so particular about it and all words found in it. Can you say what it is? Tax your brain and try again. Don't miss a word or a symbol. It isn't all that difficult.

See the end of this commentary for the answer.

(Source: [www.Brainbashers.com](http://www.Brainbashers.com))

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.

\* 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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Puzzle answer -- The paragraph does not contain an "E," but it does contain all of the other letters though.