



THE ADVOCATE GROUP

A Bridge to Financial Clarity

Weekly Commentary November 10, 2008

The Markets

Last week's business news underscored the severity of the current economic slowdown.

We all know October was a bad month in the financial markets. What we didn't know until last week was how bad the economy was faring during the market meltdown. Well, on Friday, the Labor Department delivered the dreaded news that our economy shed 240,000 non-farm jobs in October. And, if that wasn't bad enough, they significantly revised the September payroll numbers to show a decline of 284,000 jobs. The data led to a 6.5% unemployment rate in October, which is the highest rate in 14 years, according to MarketWatch.

The way the stock market responded to this news is rather instructive.

In the two days prior to the release of the employment numbers, the S&P 500 index declined a whopping 10%, according to Bespoke Investment Group. That was the largest two-day decline since the market crash of October 1987. What triggered the drop? While we'll never know for certain, it appears that some investors were selling ahead of the anticipated bad employment numbers. According to a Reuters article, "Goldman Sachs analysts had expected up to 300,000 jobs may have been cut from non-farm payrolls in October. So, when the Labor Department reported 240,000 jobs lost last month, that did not send the stock market into a tailspin even though the figure exceeded the median forecast of 200,000."

This is an example of how the stock market tends to anticipate what's going to happen and, then, reacts accordingly. On the day the employment numbers were released, the S&P 500 index actually rose nearly 3%. In effect, it was a "sell on the rumor, buy on the news" strategy.

Even armed with the knowledge that markets tend to anticipate what's going to happen, it's still difficult to try and profit from it. There are a couple reasons why. First, one never knows exactly what news is already baked into stock prices; hence, it's hard to predict how the market will react when the news is released. Second, at times the market may predict things that don't actually happen. For example, there's an old Wall Street saw that says, "The stock market has predicted nine of the last five recessions." Clearly, Wall Street's crystal ball is not always "crystal clear."

Wishful thinking aside, it appears that this time the market is accurately predicting a recession.

Returns through 11/7/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrial Average	-4.1	-32.6	-31.4	-5.5	-1.8	0.1
NASDAQ Composite	-4.3	-37.9	-37.3	-8.9	-3.5	-1.2

Standard & Poor's 500	-3.9	-36.6	-36.0	-8.7	-2.4	-1.9
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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.

ISN'T IT IRONIC that one of the major causes of our current financial predicament – borrowed money – is exactly what the federal government is using to try and solve the crisis? One has to look no further than the Federal Reserve's balance sheet. The Fed has pulled out all the stops and flooded our financial system with all kinds of “new facilities” that have dramatically expanded its assets and liabilities.

As of November 5, the Fed's balance sheet had ballooned to over \$2 trillion in assets. That's up more than 100% in less than 60 days, according to data from the Fed. And, it may not stop there. Richard Fisher, president and CEO of the Federal Reserve Bank of Dallas, said in a November 4 speech that, “I would not be surprised to see them [assets] aggregate to \$3 trillion – roughly 20% of GDP – by the time we ring in the New Year.” The thought that the Fed's balance sheet could triple to \$3 trillion in the span of four months shows how serious the Fed is about trying to minimize the impact of this financial and economic crunch.

So, where does the Fed get the money to expand its balance sheet? By borrowing, of course! Last week, the Bush administration announced plans to borrow a record \$550 billion between now and the end of the year, according to Associated Press. That's necessary to help fund our federal budget deficit, which some experts predict will hit \$1 trillion this fiscal year (2009). For the full year, government borrowing could total \$2 trillion, according to Mark Zandi, chief economist at Moody's Economy.com. Boy, a trillion here, a trillion there, and before you know it, we're talking serious money.

But, just like us normal people, the government can't continue to borrow money indefinitely without major repercussions. The government's ability to borrow is generally limited by somebody else's willingness to lend. And, those lenders have increasingly been countries such as Japan, China, and the United Kingdom.

At the end of August, the national debt of the U.S. was approximately \$9.6 trillion, according to the Treasury Department. Of that, just three countries, Japan, China, and the United Kingdom, held about \$1.4 trillion of the total. If these countries, or any of our other lenders, decide that they don't want to own any more of our paper, then we may run into trouble financing our deficits. That, coupled with the specter of rising inflation if we juice the economy too much, may act as a governor on the government's ability to add liquidity to the economy.

With that said, it appears that the government still has takers for our treasury securities and that inflation is not currently a big concern. Consequently, the government may continue to borrow money to help jumpstart the economy. Hopefully, they'll borrow just enough to get us out of this economic funk, but not so much that we end up drowning in debt from which we can't escape.

Weekly Focus – Stock Ticker

During this week in 1867, the first stock ticker was unveiled in New York City. It replaced mail and messengers and allowed investors around the country to receive up-to-the-minute stock prices. But, most importantly, the tape from the machines made for great parades!

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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