



Market Commentary

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It is very difficult to write any meaningful commentary in the midst of the frenetic volatility of the markets over the past year. However, some perspective can be gained in the turmoil of the last twelve months.

It was about this time in 2007 that worries of the sub-prime crisis began to surface in the markets, most notably the collapse of Countrywide and its subsequent acquisition by the Bank of America. Little did most know at that time the rapidity with which the credit crunch would fundamentally threaten the financial markets. Since that time, one government intervention after another has been required to prevent an all-out collapse of the economy similar to that of the 1930's Great Depression. Bear Stearns, Merrill Lynch, AIG, Fannie Mae and Freddie Mac have all been rescued. Many smaller firms such as Lehman Brothers that were not critical to the financial system were allowed to fail unceremoniously or be acquired for pennies on the dollar. It should be remembered that, at least historically, not one taxpayer dollar has been lost in previous bailouts like the Savings and Loan (S&L) crisis of the 1980s and the Resolution Trust Corporation (RTC) that salvaged the assets of the defunct S&L's. However, the magnitude of aggregate bailouts of the past several weeks exceeding \$1 trillion clearly threatening the government's venerable track record.

The market response over the past 12 months has been to fall and at times fall very sharply like the one-day 777-point drop, the biggest one-day point total ever. In round numbers, the stock market has given back about 4,000 points on the Dow Jones. The market peaked last year at a little more than 14,000 and now hovers just above 10,000 for about a 25% correction. This is not too bad considering a near brush with a complete financial disaster with oil at one time hitting \$150 per barrel and inflation becoming a real concern with skyrocketing food and energy and at the same time the general economy slowdown to the point of recession. The problem is it's probably not over yet; it is impossible to predict the unexpected, but that's what makes it unexpected.

What we do know now is that we are going to have to work through the aftermath of this financial storm for years to come. Right now we are contending with frozen credit markets, especially here in the U.S. and around the world as well. It will take a while for the "global warming" of credit to take place. Job losses are huge— 159,000 were lost in September, the biggest decline in five years with assuredly more to come. Lastly, the current cyclical business recession doesn't show immediate signs of improvement.

Is there some good news in the midst of all of this doom-and-gloom? I hesitate to say so, but yes, there is. First, oil has slipped hard, falling below \$100 per barrel, likely into the \$80's. A slower economy here in the U.S. and around the world lessens demand. In addition, some countries that were subsidizing oil have stopped forcing their populations to get back on their bicycles. Cheaper energy is like a tax cut that gets things moving. Second, because of the price of oil dropping by at least a third and a slowing economy, inflation will probably not be a big problem. Third, credit will come back but hopefully in a sensible way. Perhaps this year's hard lesson will change behavior from the individual speculator to the investment professional making stupid bets with other people's money. Lastly, the stock market always looks ahead.

The smart money is not paralyzed in today's financial funk. It's already getting ready to move in on bargains. The hockey great, Wayne Gretsky, said the secret of his success was not skating to the puck but to where the puck was going. That's what the smart investor does within the boundaries of acceptable risk.

Slavic has realigned the Conservative, Moderate and Aggressive managed Portfolios. We did not forecast the dramatic events of this year, but we did anticipate a tough year for the markets. Accordingly, we began the year with relatively large cash or short-term bond positions (Fixed Income) in the Portfolios: Conservative – 70% Fixed Income, 30% Equities; Moderate – 50% Fixed Income, 50% Equities; and Aggressive – 20% in Fixed Income, 80% Equities. This is the primary reason, despite being down so far this year, the managed portfolios have all fared well compared to the overall market. In a sense, “we have kept our powder dry” for just such a time as this. Consequently, the Portfolios have been invested with a much greater allocation to the stock market at today's lower prices.