Lassus Wherley ...a view from the top

Building Better Futures

Issue 8: September 2008

"Is It Over Yet?", Part II

The Weekend Action

The action over the weekend with Lehman Brothers and Merrill Lynch is moving us closer to a throw in the towel stage in a very volatile market. We have gone from being worried about inflation to being worried about the Wall Street model known as the investment bank or brokerage. First, there were only a few firms in this category. They included Bear Stearns, Lehman, Merrill Lynch, Morgan Stanley and Goldman Sachs. With the demise of Bear Stearns, Lehman declaring bankruptcy and now the sale of Merrill Lynch to Bank of America, we are down to two investment banks. The real issue is the way these firms did business and the huge leverage they used to maximize the profits of their business. Anytime you borrow more than you are worth and continue to invest it, you are taking huge risks.

It appears that Lehman will be broken into separate entities and sold off to many different buyers. This will be done in an orderly way but will still create a higher level of volatility in an already volatile market. At this point in the market cycle, we are throwing out the baby with the bath water. This will ultimately lead to opportunities to buy quality mutual funds that own quality companies at very low prices. This will continue to be a painful process that will take more time to work through.

This isn't the first time we have gone through a really painful market experience and I am sure it won't be the last. Some past examples are the collapse of Barings in 1994, Long Term Capital Management in 1998, the reaction to September 11, 2001, and the WorldCom panic of 2002. They have all been terrifying as we went through the experience and we have survived them all.

Monday's Market Sell-Off

With the 4% loss of value in the Dow on Monday, market values are fast approaching valuations we haven't seen in a very long time. This suggests we may be approaching a period where the value players step up and begin to invest some of that cash that they have been building in mutual funds and pension funds.

Here is some good news amid the bad news:

1) The Federal Reserve has finally drawn a line in the sand by refusing to put up the funds to back Lehman as it did Bear Stearns. This means that we, as taxpayers, aren't going to pick up even more of the costs from Wall Street failures.
2) Interest rates are likely to come down.
3) The dollar is still strengthening even though we are looking at potentially lower interest rates.
4) Commodity prices are still coming down, even in that face of the hurricane damage in Texas and Louisiana.
5) There is still cash on the sidelines that is available for investing as this market comes down.
6) The Federal Reserve has announced expansion of emergency lending for commercial and investment banks.
7) The ECB (European Central Bank) has stated that they will make additional funds available.
8) A consortium of banks have put together a $70 billion borrowing facility to improve liquidity.

I ran across an article by Brett Arends who writes for the *Wall Street Journal*. He talked about the people who make money in the financial markets. Here is a summary of a few of his noteworthy comments:

1) Stay at the table, meaning don't try to move in and out and time this market.
2) There is no way to know exactly where this market will turn but when it does it will move so fast you will miss it if you aren't already there.
3) Great investors made their money buying in panics and I certainly think the last 24 hours could be broadly classified as a panic.

As painful as these markets have been, asset allocation and diversification have worked. We will continue to rebalance based on opportunities that appear and the value of different asset classes in the financial markets. The current environment will continue to challenge everyone. It is difficult to focus on the fundamentals of investing and the long-term when you are constantly barraged by the media with their end of the world headlines. We have a difficult period ahead of us but there is no short cut for working through the issues in the financial services sector. It is more important than ever that we remember ……….. ***we are long-term investors***.

Diahann

Since we are having so many issues with Merrill Lynch and others, I thought it was worthwhile to rerun the following article from our March Issue to provide information concerning our custodians. The following section discussing the risk associated with custodians was authored by Deborah J. Rivosa, CFP®, CFA.

Question: *In light of the news about Bear Stearns (and now Lehman and Merrill), how safe is my custodian?* **Answer:** First, Bear Stearns had a long- standing reputation for being an aggressive risk taker in the investment banking business. Bad investment decisions and too much borrowed money led to huge losses, and they could not continue to cover their losses with more debt. High-risk, falling portfolios led investors to demand their money back, and at the same time, lenders were unwilling to lend them more money. The result was a liquidity crisis and the bailout by JPMorgan Chase on March 14th with the backing of the Federal Reserve.

To address our clients' individual preferences and for different situations, we work with three custodial platforms: Charles Schwab, Fidelity Investments and National Advisors Trust. **None of these custodians** are in the **investment banking business**, and they take very seriously the safety and protection of clients' assets.

Charles Schwab provides securities brokerage and financial services to individual investors and the independent advisors who work with them. They are financially sound and remain dedicated to their continued financial health. Their capital structure and liquidity are extremely strong. They are committed to risk management, and their internal controls and business standards are designed to keep clients' assets safe.

Fidelity Investments is one of the largest providers of financial services and also the largest mutual fund company in the U.S. Protecting client assets is one of their top priorities. The combination of extensive internal controls, regulatory oversight and asset protection programs provides comprehensive and effective safety of client assets.

National Advisors Trust is a federally chartered trust company, which enables us to provide a low-cost alternative to traditional trust service providers to our clients. By law, client assets are segregated from the capital assets of National Advisors Trust and are not subject to potential creditor claims. National Advisors Trust has no exposure to the subprime market because they do not provide investments at any level. They provide custodial services and act as Trustee when required.

The bottom line…investing in mutual funds as we do involves substantially less risk than accounts with Bear Stearns or Lehman or other investment banks where they are always leveraging to increase profits.

Right now everyone is **still** seeing the absolute worst in every respect, but we will get through it. In this environment, we believe maintaining a long-term focus with fully diversified strategies is critical, particularly since economic weakness looks like it may continue for a while.

Question: *Should I reduce my equity allocation in light of the current volatility in the market?* **Answer:** First, a review of your overall asset allocation may be appropriate depending on whether something has changed since the targets were originally established. Several reasons for reviewing and possibly changing your overall asset allocation would be if your circumstances have changed or your overall objectives have changed for any reason. There may also be a reason to raise additional cash if you have identified a specific need in the next 6 to 12 months for a large amount of cash. It is better to systematically raise the needed cash over a period of time than to wait until it the last minute when it is needed. This is especially true when dealing with a very volatile market.

Please let us know if you have any questions or concerns regarding the overall markets and your portfolio.