Lassus Wherley ...a view from the top

Building Better Futures

Issue 9: September 30, 2008

What Are They Thinking?

Monday's Action

Our political leaders failed to pass the "Economic Rescue Plan" today. Although many don't believe that this plan will solve all of the problems we are facing, it was pretty obvious that those in the financial markets were very disappointed with the end result. The financial markets opened down and ended up closing significantly lower with the DOW ending up down over 775 points.

This failure to pass a bill that was expected to pass and the latest action over the weekend with Wachovia has moved us into a "throw in the towel" stage in an already ugly and extremely volatile market. We have gone from being worried about Wall Street and inflation to worrying about the economy, jobs and our ability to deal with so many other issues. I will cover more on this discussion later in this newsletter.

So…...today's sell-off was driven in large part by Congress's failure to vote the way people expected them to vote but there were many other moving parts not the least of which was Hedge Funds dealing with high redemptions. Hedge funds have always used a significant amount of leverage or borrowed money. The current environment of tight borrowing combined with the poor performance of hedge funds has lead to many people pulling their money out of these funds. Redemptions mean the funds have to sell assets to raise cash while they are also having to sell assets to reduce the loans or margin they have outstanding. These liquidations have added to the volume of selling in an already negative market.

Question: Are you worried about the financial markets? **Answer:** Yes—I am concerned about what is happening in the financial markets. But I know that we will work our way through this crisis as we have worked our way through all of the crises in the past.

Question: Did you expect this type of sell-off because of Congress's inability to sign a Bill? **Answer:** I didn't expect Congress to bring a Bill forward unless they believed it would pass. But given the stalemate between the Democrats and the Republicans, the market reacted with the extreme disappointment that could be expected.

Question: What are you doing currently to deal with this market? **Answer:** We continue to review accounts to determine where there is a need to rebalance. We are reviewing cash levels on an ongoing basis to make sure that we raise adequate cash for clients who require cash distributions or have other needs.

We will continue to rebalance and move cash into this market 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 certainly difficult for all of us to focus on the fundamentals of investing in the middle of the world headlines and the craziness in the financial markets. 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***.

I have included another question below plus an article from the WSJ. They both talk about many of the things that we are all thinking about today.

Diahann

Question: *I keep hearing that we are going into a depression like the 1930s. Could that happen?* **Answer:** Irwin Kellner wrote a really good piece for the *Wall Street Journal* on Sunday night titled "Don't call it a bailout. Or a depression." I will try to summarize some of his comments because I agree with his analysis. We definitely have some serious problems in our economy and our financial system but…….the media is part of the problem and not part of the solution. Media folks are constantly looking for super headlines to sell newspapers or TV advertising. They know how to get our attention and they spend a lot of time developing

those headlines. The media business today isn't about reporting the news, its about framing the news so that people watch our show or read our paper.

Irwin's point was that a comparison of statistics between 1930 and today highlights the reality that there are more differences than there are likenesses. Here are some of his points quoted from his column.

"The crash of 1929 included a 40% drop in the stock market in a two month period of time vs. a 20% plus downturn over the last 12 months in our markets today. The unemployment rate jumped to 29% by 1933 and today it is a little more than 6%. In the 1930s more than 9000 banks failed compared with fewer than 20 over the past couple of years."

"Remember, also it was policy errors, not the stock market crash, that caused the Great Depression; instead of increasing the money supply, the Federal Reserve of that era reduced it by one-third and instead of lowering taxes, Herbert Hoover raised them."

Irwin goes on to talk about many other factors for comparison but I think the above make the point that we are in a different situation. We have FDIC insurance for our banks and a Federal Reserve that has been very responsive in terms of providing liquidity to the system.

One other point that he makes is that the "bailout" is not a bailout of anyone. "It is an infusion of liquidity, designed to unclog the financial markets." Whether you agree with the current government plan or not, there is certainly a need to do something to guarantee the continued liquidity of our financial system so that banks can lend money to businesses and individuals that need it.

I added the following WSJ article written by Jason Zweig because I thought he did a really good job of getting some of the critical points across.

Tuesday, September 30, 2008
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The Wall Street Journal
The Depression of 2008? Don't Count on It
By Jason Zweig

Wall Street is dead.

Whether it was murder or suicide is beside the point: Wall Street as it has operated for the past 75 years has been obliterated in a matter of weeks. And witnessing this violent death in broad daylight has traumatized investors everywhere.

The Wall Street domino has toppled just about everything in sight: U.S. stocks large and small, within the financial industry and outside of it; foreign stocks; oil and other commodities; real-estate investment trusts; formerly booming emerging markets like India and China. Even gold, although it has inched up lately, has lost 10% from its highs earlier this year. Not even cash seems entirely safe, as money-market funds barely averted a "run on the bank."

Of all the dominos that have tipped over, the most psychologically damaging collapse was the last: the very notion of diversification itself.

Every day, my mailbox fills up with messages from agonized investors who can find nowhere to hide. The most common refrain: "I've lost money on everything." If you feel this way too, you are certainly not imagining. According to the researchers at Morningstar Inc., 91% of all mutual funds in existence have lost money so far this year. To put that in perspective, in 2001 -- the year Enron imploded, Internet stocks kept crashing and al Qaeda attacked the U.S. -- more than one out of every three funds still managed to generate positive returns.

How much worse might things get? Is there any way to prevent Wall Street's death from taking you out too?

Let's consider some of the arguments that have been surfacing lately.

"We're going into another Great Depression." The failure on Monday of the U.S. House of Representatives to pass the bailout plan makes those G-D words seem possible for the first time. But I don't think another depression is likely, for two reasons.

First, when you spend time studying the Crash of 1929 and the depression that followed, what stands out the most is the dearth of doomsayers. Even Roger Babson, the economist known to posterity as

apocalypse that actually occurred. Depressions start not when lots of people are worried about them, as we have today, but when no one is worried about them, as in 1929.

Second, the Great Depression and the Panic of 1873 (which triggered what arguably was the worst depression in U.S. history) both occurred before the Federal Reserve Bank had aggressively grown into its role as "lender of last resort." In the wake of 1873, after a railroad-building boom had swept the nation and then gone bust, companies and consumers alike were left gasping for capital. Nothing but the passage of time could supply it; the Fed would not be established until 1913. After the crash of 1929, when the Fed was still weak, years passed before the federal government could flood the economy with cash.

Today, however, the resolve of the Fed is not in question; nor is there any doubt that the Treasury Department is willing to provide the financing it takes to get the economy moving again. Furthermore, U.S. nonfinancial companies have just under $1 trillion in cash on their books. Even though Wall Street is dead, innovation is not: In the months to come, clever new financial go-betweens will spring up and find a way to get that cash flowing again. It's hard to see how a depression could get under way when so much capital is waiting in the wings.

"Diversification is dead." There's an old saying that the only things that go up in a down market are correlations -- the tightness of the linkages among various assets like U.S. and foreign markets, stocks and bonds, commodities or real estate. Normally, one asset will tend to zig while another zags. But in bear markets, they converge -- and in really terrible bear markets, they move in complete lockstep.
That's what is happening now, but it will not last indefinitely.

It never does. While diversification does not work all the time, it does work over the course of time. There's nothing wrong with raising a little cash if that would prevent you from panicking completely. This is particularly true for retirees. Whittle down your stock position gradually, in baby steps -- say, 1% at a time -- not in one fell swoop. And set a limit beyond which you will not go; otherwise, when stocks stage their inevitable recovery, you will miss out.

"Investors hate uncertainty." Well, that's just tough. Uncertainty is all investors ever have gotten, or ever will get, from the moment barley and sesame first began trading in ancient Mesopotamia to the last trade that will ever take place on Planet Earth.
If tomorrow were ever knowable with absolute certainty, who would take the other side of a trade today?

The financial future is no more uncertain now than it used to be; in fact, it's far less uncertain than it was in the summer of 2007, when the Dow shot above 14000, the future seemed bright, and utterly no one foresaw the disaster that would befall the financial system. The absolute certainty of blue skies ahead was an illusion then, and the notion that we all know that worse misery lies in store is an illusion now.

The only true certainty is surprise.

You've probably spent a lot more time worrying about negative than positive surprises lately. But we could get surprised on the upside by a further fall in oil prices, a kick from low interest rates -- and, of course, untold other possibilities that no one can foresee.

Whatever happens with the bailout, don't bail out.

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Please let us know if we can be of assistance in answering other questions you may have concerning your financial situation.

Diahann