

Perspective on Recent Market Turmoil

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For Immediate Release

Over a year into a credit crisis that has consistently exceeded the market's expectations in terms of depth and severity, conditions have recently intensified. Financial institutions' access to fresh capital, which has so far been their lifeline has all but dried up, causing Lehman Brothers to go bankrupt, Merrill Lynch to be sold, AIG to receive an unprecedented government bridge loan/takeover, and left investors in general to wonder how many other firms are likely to fail before this is all over.

Clearly the financial system is under a tremendous strain that will take some time to run its course. The problems that led us to this point developed over a number of years, and will not be corrected overnight. However, we feel that it is especially important right now, when investors are most tempted to abandon their plans and let emotion take over, to remind our clients that this crisis will be resolved in time. The Federal Reserve and other central banks around the world are committed to providing liquidity to the markets and have shown a willingness to take unconventional steps to maintain the integrity of the financial system. At the same time, there are other forces at work that may help to keep the economy moving along, notably falling oil prices, lower mortgage rates, and good health among corporations outside the financial sector.

In support of our view that now more than ever investors should adhere to their plans, we point out the following key factors:

1. **The economy matters.** The US economy has weathered numerous periods of turmoil in the past and has spent far more time in a state of expansion than recession (about 84% of the time in the post-WWII era). While the events of the past week are shocking, they most likely will not prevent the economy from resuming a path of moderate expansion. It is also worth noting that the economy has yet to fall into negative-growth territory; in fact, real GDP grew at a 3.3% annual rate in the quarter ended 6/30/08.
2. **Valuation matters.** Markets are always most dangerous when investors are complacent and valuations are extended, but this simply doesn't appear to be the case right now. The forward P/E ratio on the S&P 500 is currently 12.9x, which is about 23% below its historical average of 16.7x and less than half of the 31.4x ratio seen at the beginning of the last recession in 2001. Additionally, a comparison of the S&P 500 earnings yield against the 10-year Treasury yield suggests stocks may be as much as 51% undervalued relative to bonds.
3. **Diversification matters.** Many stock markets around the world are closely correlated and all are suffering from the turmoil of the last year. That is why it is important to have bonds and alternative investments in a diversified portfolio.

4. **Discipline matters.** We can see the effects of human nature on investment returns when we compare the average return of stocks over the past 20 years (11.9% annualized) with the return of the average stock investor (4.5% annualized). The unfortunate side to this is that successful investing means buying and selling at times when it doesn't feel comfortable; the upside is that disciplined investors who have a plan and stick to it tend to be handsomely rewarded over the long-term. We can also take from history that rarely has selling stocks after a 20% decline been a wise financial move.

Acknowledging that investors are facing arguably their greatest challenges in a generation, we believe that the tumultuous events seen so far in the credit crisis are not sufficient to merit major changes to your investment plan. If you are a client of our firm, it's important to remember that you have a sound plan, you have a diversified portfolio and you have expert investment managers selecting securities on your behalf. The important point is that given enough time, we are fully confident that markets will regain their footing and ultimately produce positive returns. That said, if changes in your personal situation have altered your time horizon, we ask that you contact us so we can review your plan (just as we would under favorable market conditions). If, however, your time horizon remains long-term, we believe that patience and discipline, as well as proactively rebalancing to capture opportunities as they emerge, are warranted and will ultimately be rewarded when the market cycles back to recovery.

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