

Market Commentary: 4th Quarter 2009

Two dramatic events will happen in October: peak foliage and the first frost. These are two very different, both beautiful, occurrences that will take place very close to one another. One is a finale, the other a beginning. We hope that over the course of the next several months, two events will unfold in the economy: a public stimulus finale and an overture of increasing private sector spending. Although the timing is in debate, we are certain that this is the eventual solution for the recession's end.

October is often seen as a scary month in the markets, with or without a costume. The transition in our economy from recession to growth will not be an easy one. The worsening unemployment picture, which is not likely to improve until next year, is one clear piece of evidence. Clearly, we should not expect steady consistent growth now that the worst has passed. The stock market has jumped up quickly with the dissolution of the worst fears and the expected return of growth, but serious economic and geopolitical risks remain, so, on the whole, the future is quite fragile.

For the third quarter, like the second, all of the major stock indices, U.S. and international, were strongly positive. The S&P 500 and NASAQ both gained 15%. The broader U.S. index, the Wilshire 5000, and the benchmark international index, MSCI EAFE, ended the quarter 18% and 17% higher respectively. The prices of fixed income securities also grew between 2%-4%. If one had been asleep during the last 12 months, the returns on stocks would leave you wondering what all the fuss was about. Looking only at the numbers, you might think this was a "normal" mixed year that any investor should expect. With the exception of the tech heavy NASDAQ at 3%, all the other equity returns were minus 2% to minus 10%. Fixed income returns were positive generating 7%-9% with the exception of TIPS which yielded 1% for the year.

However, none of us was asleep or unaffected this year. We must take stock of what we learned and count it as gain. In William Shakespeare's words, "Experience is a jewel, and it had need be so, for it is often purchased at an infinite rate." In the last year, while everything was seemingly falling apart, together we were focused on making rational decisions. Should the market decline precipitously again, *we will take the same actions as before*: immediately review the specific equity exposure and cash flow risk, and then intelligently rebalance based on foundational principles and new challenges. Still, this year a strong "well done" is deserved on your part. Making rational decisions was not easy to do, but together we were successful!

In spite of this, we clearly recognize that some things have changed; therefore we must study and adjust accordingly. Here are two of several shifts in the economic

landscape that figure into our strategies for you. First, a curious result; government responses to the crisis around the globe have brought countries closer together. The U.S., through its various massive stimulus packages, implemented (because it had to) some central planning-type economic measures. In Asia, China implemented, quickly and effectively, a massive stimulus but also embraced more free-market regulations and entrepreneurial methods. Policy makers' minds in both Asia and the U.S. are reforming health care. China and Korea are expanding health care, pension and welfare systems. Grave geopolitical concerns like Iran still divide many countries, but overall the economic crisis has caused more policies to resemble one another. [The moral: global diversification!]

Secondly, though speculation has always been a part of the market, it is now magnified by global participation and promoted through institutions which previously acted more like investors. John Bogle, the founder of the Vanguard Group, in his new book "Enough" said "We live in the most speculative age in history." Bogle supported this statement by explaining that the annual turnover rate of stocks was 25% in 1951, 100% in 1998, and 215% and 284% in 2009 for mutual funds and ETF's respectively. In the long-run returns from stocks are created by growth in the intrinsic value of companies, not return from speculation. However, disappointingly, we expect more volatility for a similar historical return.

One positive change from this crisis that we hope remains is an increased savings rate among Americans. However, a true change in behavior must be positively motivated, not fear driven. We hope that when the unemployment rate starts to fall next year that the savings rate does not go down with it.

So, as we wonder whether the last quarter of the year will be a trick or a treat, we are confident about our strategies and process. We know the economic landscape has become more complex and calls for additional vigilance on our part. We will adjust even as we continue to focus on the principles that will bring success. Costs must be low. Risk is rewarded. Diversification is the greatest element in risk reduction. Cash flow drives portfolio function. Markets move quickly, in both directions. Transparency breeds trust. As always, in our frequent reviews with you about investments and other planning matters, we will continue to review these fundamentals.

The harvest season reminds us of your trust and loyalty – thank you.

Carl Amos Johnson, MBA, CFP®, AIF®
October 5, 2009