INVESTMENT UPDATE NEWSLETTER

ALLEN TRUST COMPANY

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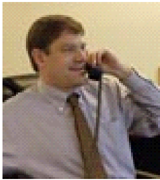

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Portfolio Manager

Fear Itself, and Opportunity

The tumult in the markets has been a terrible thing to behold, and trying for many to endure. We ended October with the S&P 500 down some 35% on the year, corporate bonds and long munis alike off almost 15%, and even "safe" havens such as Treasuries and gold starting to flag (a turn which, counter-intuitive though it may seem, may actually signal an improving broader outlook).

Because facts can be an effective antidote to fear, we held a client lunch at mid-month to give some historical perspective on previous episodes when, financially speaking, the world seemed about to end, yet didn't. I'll repeat the main points here.

The Nature of Panics

- The herd impulse overwhelms most participants' sense of individuality excepting one instinct: self-preservation
- Perspective shortens up such that the moment takes over; appropriate investment time horizons are jettisoned
- All panics are temporary; no system can remain perpetually in a state of crisis
- As the weak money washes out, the patient money prepares to profit
- Those who succumb to panic are those most likely to look back and kick themselves: "Why did I do that?"

Why this is Not another Great Depression

- Manufacturing and agriculture do not dominate US payrolls and GDP now as they did in the 1920-30s; our cyclical vulnerabilities today differ
- Corporate balance sheets (outside of financial services) are coming into this downturn relatively sound
- Federal deposit insurance (absent then) has prevented a collapse of retail banking; the system continues to function for day-to-day Main Street purposes, dysfunction in the capital markets notwithstanding
- While not faultless, government intervention has been dramatic and constructive
- Global coordination of response is winning out over protectionism
- Fiscal policy efforts are ramping up sooner rather than years late

What History Tells Us about Market Downturns and Recoveries

- Stocks declined by more than 20% seven times 1926-2007, losing 39% on average
- Prophesies of permanent doom have accompanied each bear market
- On average, it took 16 months to reach trough
- We won't know the bottom when it comes; we know only that it always has
- On average, it took 3.5 years from trough to recover to prior highs; excluding the Depression, recoveries took 2 years on average
- In the calendar year following each of the worst downturns of the last century (troughs reached 1932, 1974, 2002), stocks rose 54%, 37% and 29% respectively

All data derived from Ibbotson-Morningstar, Inc.

In Conclusion

We are not so blithe as to say financial meltdowns are much ado about nothing. Even so, if your investment time horizon hasn't changed (and for most of you, it shouldn't have) and you have cash enough to meet your needs, the best thing is to steer by a distant point on the calendar.

Times like this are least likely to reward the comfortable choice. We will buy slowly and with discrimination in the face of indiscriminate selling, taking heart from history's lesson that when doom seems at hand, there's probably opportunity for those who can be patient more than brave.