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Where Do We Go From Here? by Bill Perryman

As I sit composing my thoughts on January 21, 2008—Martin Luther King, Jr. Day—we have just experienced the worst three-week period to start a stock market year in my almost 25-year career. The Dow is currently at 12,099, the S&P 500 at 1,325 and the Nasdaq at 2,340—down 8.79%, 9.75% and 11.77%, respectively in 2008. Is this just the beginning of a horrible downturn in equities and our economy, or is the worst behind us? I wish I had all the answers, but I do not. What I do have, as always, is an opinion. I would like to think that this opinion is based on facts and not just a regurgitation of what you are already hearing and reading 24 hours each day in the media. Let me start with my conclusions and then I will follow with my reasoning:

1) I do not believe we will have a recession.

Despite the residential real estate meltdown and the subprime crisis in the financial sector, the balance of our economy continues to be quite strong; other than the real estate and financials sectors, the quarterly earnings of companies in the S&P 500 grew by double digits in the 4th quarter of 2007.

While the economy is slowing and likely will continue a pattern of slow growth in the first half of 2008, I do not believe we will see negative GDP for two consecutive quarters before we see the economy strengthen in the second half of 2008.

Furthermore, a recession does not always imply poor stock market performance. Since World War II the U.S. has experienced 11 recessions; during those 11 recessions, the S&P 500 has averaged a gain of 9.1%. Therefore, it is accurate to conclude that the fear of a recession is usually more detrimental to stocks than the recession itself.

2) Relative valuations of stocks are at their lowest point in almost 20 years.

Many of you were invested in the bear market during 2000 to 2002. Being involved in a volatile market creates powerful emotions that color our perceptions. But let's look at where we are today compared to the market in 2000–2002.

	March 24, 2000*	January 21, 2008	%Δ
S&P 500	1,527	1,325	-13%
10-Year Treasury Bond	6.28%	3.53%	-44%
Forward Earnings of S&P 500	$60.00	$102.00	+70%

*The date the market reached its all-time high

The decision to buy equities is based on their relative value to fixed income securities. The higher interest rates are the less inclined one is to take risk and invest in the stock market; inversely, as interest rates fall, stocks become more attractive. The numbers above show that interest rates have fallen 44%, earnings have risen 70%, and the market is 13% lower than at the peak in 2000. What this indicates is that stocks are much cheaper than they were at the 2000 peak. At the same time, earnings are greater and interest rates are lower. While this does not mean that the market cannot continue to fall, it does illustrate that stocks are significantly cheaper today than in 2000. Theoretically, under these circumstances, money should flow from fixed income to equities.

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Market Watch

	1/21/2008	YTD
DJIA	12,099	-8.79%
S&P 500	1,325	-9.75%
NASDAQ	2,340	-11.77%

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Where Do We Go From Here? -(cont.)-

3) The market is demanding Bernanke to lower the Fed Funds rate.

Each new chairman of the Federal Reserve is tested by the markets. Within his first year of taking over the Fed, Alan Greenspan weathered the worst one-day plunge in history on October 19, 1987. Bernanke's challenge is the subprime banking crisis. Today, the federal funds rate is 4.25%; thus, the market is indicating that it is 1% higher than it should be. Hopefully, Mr. Bernanke will heed the warning and respond aggressively by lowering interest rates in order to avert more damage to our economy.

I want you to know that downturns in the market are just as painful to us as they are to you. We are diligent in attempting to develop long-term investment strategies which will provide excellent returns over the long haul. We believe the recent drop in the market will be short-lived and that you will be rewarded by continuing to follow the financial and investment plans we have created in order to secure your future.

We sincerely appreciate you and know that we only exist because of you.

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