Here is an article that Bob Keats has written that discusses the current market conditions.

Good News

The Sky Is Not Falling

After a recent conversation with a very good and experienced public relations person who communicates with hundreds of reporters and other news media persons monthly, I felt I might be able to contribute something positive to people's lives amid the seemingly never-ending barrage of bad economic news coming from the public media. This PR person advised me that all of these media people, who are constantly shaking the bushes for news to put on the air or in their publications, are totally ignoring news items that are positive things happening and jumping on anything that is negative, looking for the most sensational aspect, the blood-in-the-street-type story, and nothing else. This is the grassroots of what people are being hit with day in and day out every time they turn on the TV or pick up a newspaper or go to their favorite news Internet sites. The reporters spin the news in whatever direction they feel will help them sell the most newspapers or TV spots, and truth and accuracy seem to be things that are only included accidentally or when they can spin it to be totally in line with their blood-in-the-street stories.

When dealing with individual financial matters, we are constantly facing two of the greatest emotions that drive our human psyche: greed and fear. The media have managed to create a level of fear and panic in people's lives well beyond reason and logic. A recent example—and there are many more—involves a longtime client who was so worked up about the news media reporting that she couldn't sleep from worrying about her portfolio and how it had lost some of its value. She came into the office with a great deal of fear and panic and wanted to liquidate her portfolio at any cost. When we told her that she would have a substantial tax cost to cash in her securities because of some very large capital gains in her portfolio, she was a bit incredulous as well as relieved and said, "How is that possible? You mean I didn't lose money?" This client's portfolio over a period of years had grown at the rate of about 6% a year; and although it had dropped from its recent high point, her portfolio had produced a substantial amount of income and was still valued substantially higher than what she had placed in the portfolio. In short, all her fear and worry created by this media barrage of negativity

that had convinced her that she had lost nearly all her money was totally unfounded, even though it was very real in her mind.

This story doesn't imply that clients have not seen some of their portfolios diminish from recent high water marks over the past year. Instead, my key point is that fear is an emotion that can get the best of us and make us act in unusual or self-destructive ways if we don't sit down and actually look at the facts—in particular, positive facts. Emotional reactions work in both directions, and one of the hardest times I've had in my 30 years of dealing with similar issues was with greed rather than fear in the mid-to-late 1990s. We had so many conversations with clients trying to talk them out of getting on the bandwagon of the "dot com" tech stock boom at the time that the media had hyped it as "easy money". Clients couldn't understand why we insisted on keeping their portfolios diversified and chugging along at 6 to10% returns a year when the news media were reporting so many sensational stories about people easily doubling their money overnight. Those clients who took our advice came out of that eventual disaster very well, while those who did not lost substantial sums of money. I believe we are in a similar situation now, except that the driving emotion is fear rather than greed.

Although it's taken me the first two paragraphs of this article to get to some of the positive news I want to portray, and that I believe the news media is missing, I wanted to set up a backdrop to help people understand that financial decisions based on emotion, either greed or fear, usually work against them. The best way to counteract the negative emotion of fear is to shine a light into the darkness and see what positive tidbits that light reveals.

The first bit of good news is that our financial markets have never gone down forever—just as they have never gone up forever. In other words, there will be a bottom to this current cycle. Roller coaster designers purposely design their roller coasters such that when you're at the top you can't see the bottom because they want to generate maximum fear even though everyone riding the roller coaster knows there is a bottom point that they will reach safely, even though they weren't able to see it from the high point. We have been on this market roller coaster long enough to know that although there still may be several twists and dips to go, we are getting closer to the bottom. And we will only know exactly where that bottom was by looking back in hindsight.

Since we might be approaching the bottom point, I believe a positive exercise is to look at what logically and realistically could happen over the next 10 years. Using Standard & Poor's 500 as an indicator for decade-ahead equity market performance, and using current market valuations as our starting point, the decade beginning this year could provide reasonably good returns of roughly 10 to 15% per year. (I use the S&P 500 Index because it has 500 stocks and thus better represents the U.S. stock market than the Dow Jones Industrial Average, which has only 30 stocks).

How do we arrive at what seems like such an incredibly good return? We need to look at three components that make up this return number. The first component is the S&P price/earnings ratio. The price/earnings ratio is the number of dollars in stock price a

willing investor pays for one dollar of future earnings. Currently the S&P 500 price/earnings ratio is 8 to 12 times earnings. The S&P 500 historical price/earnings average has been around 18 times earnings, and bear (or bad) market cycles traditionally have started at 25 to 30 times earnings, while bull (or good) market cycles have historically started around 10 times earnings. To get back to the historical average and not even get into the higher bull market ranges price/earnings ratio, the S&P 500 would require more than a 5% per year increase in value over 10 years.

The next component of this possible 10%+ return is the amount of income or dividends paid out per share, called the dividend yield. The dividend yield is calculated as the entire year's dividends divided by the current share price. For an index, this is the weighted average of all dividend yields in the index. The dividend yield for the S&P 500 is currently over 3.4%, and the past 10-year average was 1.4% (please note that if prices increase and the dividends stay the same, dividend yield will go down). The final component of the total return number is the earnings growth of 4 to 6%. Earnings growth is simply the annual increase in net company income, and it has averaged around 6% over the past hundred plus years. Even though earnings growth has been hit during this recession, a majority of the companies in the S&P 500 are predicting better-than-average earnings growths as we pull out from the bottom.

If we add all three separate return components together (a 5% annual valuation increase, a 3% annual dividend yield, and a 4% annual earnings growth), we get a 12% average annual return over 10 years. There never has been any period where there has been a permanent up or down trend in the price earnings ratio or the other two components of this calculation even though there have been extended periods of time of both over and under performance. This doesn't mean that I'm predicting all our client portfolios will provide 12% annual returns over the next 10 years. The S&P 500 or its equivalent is only one component of the complex and globally diversified equity investments we recommend for the growth portion of a client portfolio. Client portfolios also would normally include a substantial amount of fixed income investments and inflation hedges which provide more balanced return and a reduced risk. My key point here is the markets do turn around, regardless of how many times somebody on CNBC tells you the sky is falling or this economic cycle is different than all others, and that when they do turn around returns can be substantial enough to recoup most of, if not all, past losses and maintain clients on their long term investment targets.

Reviewing the average gain from the beginning of the previous 22 U.S. bull markets over many decades (based on the Dow Jones industrial average) the average gain was 18.1% in the first three months, 26.4% in the first six months and 45.8% in the first year. The total average bull market gains over the 22 full markets amount to 83.6%, so if one is out of equities during the first few months or year of the start of a bull market they could miss over 50% of the recovery gains. With the current very low valuations, one might reasonably expect that a bull market recovery would be better than the average.

Other good news that seems to escape reporters comes in the real estate market; which normally does lead the stock market in either direction. Real estate, as everyone knows, has many different regional effects. Phoenix, AZ, one of the worst hit real estate markets in the country, is an example where the market appears to be turning around. Home sales are up 250% in the first quarter of 2009, over first quarter of 2008. Investors were the majority of sellers in 2005 and this year-to-date have been the majority of buyers. Traditional real estate investors understand where we are at in market cycles better than the average homeowner and they have billions of dollars of cash they are currently investing. Homes, which are not in the fringe areas of the city, in the most popular price range of $150,000-$250,000, are experiencing many one day sales and virtually all the inventory is sold within 30 days. With prices this low and interest rates lower than any time in about the past 50 years, along with some new tax incentives, house affordability has probably never been better than any time in history. There is plenty of financing for those that have been diligent in keeping their credit ratings solid. The inventory of houses for sale has been steadily dropping and few builders are adding new houses to that inventory of houses for sale. Because of that, the homes for sale inventory is far better than it has been for the past two years and is likely to continue to drop over the next couple years to allow a new building cycle to begin.

Other good news is that people's dollars are going much farther than even a year ago. Anyone that has booked an airplane ticket recently, travelled to Europe, booked a cruise or a resort vacation, filled up the gas tank, or bought a new house or car are getting phenomenal bargains relative to the prices we had to pay only a very short time ago. It is often good to remember that even if your investment portfolio may be down, your relative position—when measured against the general population's economic situation and your ability to deal with the economic needs of life—may be unchanged. For example, those with a net worth exceeding $1 million are still in the top 10% of the entire population of the country and an even higher percentage when considering the worldwide population. Those with a net worth in excess of $5 million remain in the top 1% of the population. Even if this crisis continues to worsen, in spite of the fact that the value of your net worth when measured in dollars may be dropping, the economic power of those assets may actually be increasing—particularly if you have a plan and a strategy and are sticking to it. I believe all of our clients do have a plan and we are working on helping them with the discipline to stick to it.

I am quite amazed, but not surprised, at how quickly the majority of the investing population is willing to abandon some of the most basic investment principles historically proven over hundreds of years, when driven by the fear or greed fueled by media hype, primarily at respective bottoms or historical peaks of market cycles. That population includes my own peers in the investment advisory business, my own employees, clients, family and friends. We are all emotional beings. There is no doubt we are in a perfect financial storm. However, if you were on a ship in the middle of an Atlantic hurricane, it is not the time to throw the captain and crew overboard and attempt to rebuild the ship while it is still in the water. As long as you were well-prepared for the trip and had a solid emergency plan, your chances of reaching your destination will be

reached and the rough waters a distant memory. If we all work together, I am absolutely certain we will get through this storm stronger than before and we certainly will enjoy the ride a lot better once we have safely weathered it and are in calm waters again.