June Gloom and the Summer Swoon

You don't have to look at your most recent statements to know that June served up a big setback in markets and sectors across-the-board. Even the famous Warren Buffett's firm experienced the worst first half since 1990 with Berkshire Hathaway down by almost 20% since the beginning of the year.

The bad news is all of the major stock indices have been swinging wildly for the past few months, but with a general trend downward. A few indexes dropped back to or slightly below March 10th lows. The S&P 500 has seen three "triple bottoms" in the first half – January, March, and June.

The events that cause investors to sell stocks keep repeating – worries about high oil prices, gold, the credit squeeze, a strong Euro and falling housing prices. Each dip has been followed by a burst of optimism with indexes and hopes rising, only to fall again with the next chunk of bad news.

Early in June we saw a couple of events that added fuel to the decline. Unemployment vaulted from a respectable 5% to a less desirable 5.5% in a single month. If my history is accurate, it's been 22 years since we have seen a move in employment data this disturbing. The second, and more troubling to the market, was the rapid jumps in oil prices. In a period of a couple of days we saw crude jump $16 in 48 hours. We all know the pain that rising oil prices are causing, and the press is fueling the panic talking about $200 barrel oil and the end of our life style as we know it. So the fear and loathing over oil's inevitable.

But the good news is I'm not convinced it means anything at all as far as long term investing.

Fear Factor

It seems that we, as investors, are plagued by a fear that it "could get worse." Perhaps, it can, but I don't believe the current economic data supports the high levels of dismay running rampant.

The annualized yield on the 10-year Treasury bond is around 3.95%, the prime-lending rate is 5%, 30 year fixed mortgage rates are 6.37% (MSNBC July 10th) and 15 year mortgages are about 5.92%. Money is available to top-quality borrowers at reasonable rates. And as mentioned earlier, unemployment may be at 5.5%, but currently we are still below levels seen in late 2003 and early 2003.

What is probably most worrying today is the extent to which rising costs for energy and raw materials will impact corporate profitability. Oil prices are a big wild card. While there are reasons to believe we won't see any progress prior to the November election, even with a spike over $150 a barrel, we think a case can be made for lower prices ultimately (one estimate heard on CNBC was that a third of current oil price is related to the value of the dollar).

We think a case can be made for contrarian thinking in the face of media-driven 'fear factors." No trend lasts forever. Trees don't grow to the sky and oil gushers (and oil prices) are subject to the law of gravity. Economists continue to debate whether we will experience an official recession of two successive quarters of negative GDP growth. But things are slow now, and we are seeing market prices and lows that we've not seen for several years. But most economists figure the recession – whether it's here now or coming – will be relatively shallow as recessions go.

One thought to remember – it's never as bad as politicians and the news services tell you. It is pre-election, and it will never be a good as promised post-election (or as bad as some fear.) Given all that we have experienced – the credit crunch fallout, the collapse of the housing bubble, sky-high oil prices, gas over $4 (and diesel approaching $5!), a war that seems to have no end, rising inflation, a U.S. dollar that has lost significant value, it's amazing we've not fallen off the edge of the world. But we have not seen the dire consequences some observers might have predicted. There is cause of optimism and hanging in there.

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Look Past the Hype

Every now and then we have to remember to look beyond performance. Look at your holdings and see whether you have a diversified portfolio covering many different sectors and locations in the market. If you do, then you'll likely not be experiencing the full decline of the market because there are segments of the market that aren't being hammered as much as others. And declines in certain segments – financials for example – are providing managers opportunities to boost holdings in good companies that have been beaten down with the bad. It is not fun while you live through times like today with weak, confused and volatile markets, but it's these very markets that provide the basis for adding longer-term value and ultimate profits.

A market recovery may not come tomorrow, or next month or even in 2008. But it will come if history can provide any comfort. If you think back over the past few years, the stock market has seen sharp reversals in reactions to oil prices and dollar weakness that have lasted for several months. But historically (despite not being a guarantee of future results) volatility, while never-wracking, has proven profitable and prudent to ride through such periods.

Five year CD rates on average offer annual yields of around 3.99%, but even excluding taxes with inflation running 4.18% (June, 2008 number) you have a negative real return. With everyone living longer, and the need to consider long-term buying power, what is the alternative? Being invested in the stock market is probably one of the best ways to stay ahead of inflation – but it takes patience and faith in the system.

With the economy slowing and the stock market falling, it's easy to lapse into a spirit of pessimism. But we don't think this is well founded – not economically, and certainly not as a citizen of the greatest country in the world.

Recessions and bear markets like each other. Watching the value of our investments go down during these times is very hard to do. But if you have sufficient short term reserves, and have a long term perspective and are well diversified, you are doing the things that will help manage risk and reduce the volatility of price movements. Such an approach avoids the chance of selling low only to buy later at a high. Risk can never be eliminated, so the key is to find a medium between risk and return that will ensure you achieve your financial goals while still getting a good night's rest. If you have questions or concerns, we're just a phone call away and we're always glad to discuss your personal situation.

Thank you.