

PERSPECTIVE FOR TRYING TIMES

This is a scary time and, for most investors, this period is unmatched in recent history. We understand your concern about the stock market. We cannot predict when this recession will end or when the stock market will recover. No one can; those events are only marked in history. Perhaps you want to consider these few points for some perspective.

As it relates to this recession:

- The longest post-World War II recessions (December 1973-February 1975 and August 1981-October 1982) were 14 months. The average post-World War II recession has been 9.6 months.
- We already are 15 months into the current recession, which began in October or November 2007.
- The laws of supply and demand are, over time, immutable. Recessions do not – and, in fact, cannot – last forever in free-market societies. People may be saving now and putting off big-ticket purchases. However, they eventually will need to get new cars, replace their refrigerators and buy new clothes.

As it relates to the stock market:

- The S&P 500 Index has had 59 years with positive annual returns and 24 years with negative annual returns since 1926. In other words, the stock market has posted positive returns 71 percent of the time!
- The long-term annualized return for the broad market is about 7 percent. The market has seen “up” years and “down” years but the long-term trend line on equities is up.
- No decade since the 1930s has had more than three down years until this decade. We have had four. History would suggest the odds overwhelmingly are that the market will turn positive again.

THOUGHTS

- The stock market historically has been a leading indicator of the overall economy. In other words, it generally recovers before the economy.
- We are more than 15 months – well past the average – into the current recession.
- Some market observers have suggested the market is currently undervalued. We discuss that on the reverse side.

- Some stock-market observers, including Jeremy Siegel, suggest the stock market right now is undervalued and this may be a good time to re-enter the market.

There has been a lot of news suggesting an S&P 500 Index “bottom” at 600 based on the idea that the index’s earnings for 2008 could be around \$40. But, as Siegel and others have pointed out, those earnings are equally weighted among the 500 member companies.

He has suggested that, instead, the earnings should be capitalization-weighted so that those of larger companies have a larger impact than those of smaller companies. Using a weighted measure, Siegel has suggested 2008 earnings around \$70.

Using Siegel’s earnings estimate and applying an historical price-to-earnings (P/E) average multiple of about 15 times earnings, that would suggest the S&P really should be above 1,000: a significant move from recent levels! And that reflects today’s trough earnings in a dismal economy; it doesn’t take into account the increased earnings an economic recovery likely would bring.

- Bloomberg News calculated at the end of December that there was more than \$8.5 trillion in cash, bank deposits and money-market funds where returns will lag even today’s modest inflation rate. That money likely will flood back into the equities market – driving stock prices much higher – when investors realize that near-zero returns feel safe but are not a way to meet long-term investment goals.
- Waiting to see that the stock market really has begun a bull run inevitably means missing a good portion of the market’s gains. The only way – beyond the blind luck of calling a market bottom – to catch the dramatic outperformance that comes when the stock market begins an up cycle is to be invested BEFORE it occurs.

Past performance is no guarantee of future results.
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