Helping People Manage Their Money

Your Money

September 30, 2008

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EQUITY BASICS

At times like these, it becomes easy to second guess the decision we made to invest a portion of our life savings in equity type investments. We all enjoy seeing the tremendous bull market runs like many of us experienced in the late nineties or the five years prior to 2008. However, when the bears crash the party, feelings change, and often change drastically.

Under the circumstances, it is vitally important to maintain your discipline and stick to your plans for long-term financial success. In the end, the decisions you make will be the single biggest determinant to achieving your goals.

There are four inherent truths to equity investing and the market cycles we experience.

Truth #1: Over the longer term (periods in excess of two to three years), stocks are tied to the underlying economic conditions. In the short term (periods of one to three years), the movement in stocks is only constrained by their capacity for emotional excess.

When times are good, *they appear really good*, and when times are bad, *they appear really bad*. During bull market runs, the emotional extremes lead to excessive and unwarranted increases in equity prices - just like the late nineties and the dot.com craze. When the economic cycle moves the opposite direction, the human emotional reaction is just as extreme - such as the one we are experiencing right now. Our current situation is no different than any other time since World War II. While it may look different on the surface, underneath, it really isn't.

Truth #2: Bear markets are a common element to equity investing. Since 1946, our country has experienced thirteen bear markets including our current bear. On average, the bear wakes from hibernation every 5 years. Unfortunately, the bears timing is not precise.

This means that in a persons working lifetime of forty years, a bear market will be experienced roughly eight times. During an average healthy 62 year old couple's retirement, they will experience roughly five such events. It is going to happen.

(This also means that four out of every five years, the stock market goes up.)

Truth #3: A bear market is the *temporary interruption* of a seemingly permanent increase. At the beginning of the first post WWII bear, the S&P 500 closed at 19.3 (May 29, 1946). On September 30, 2008 the index closed at 1,164.74, *thirteen bear markets later!*

In 62+ years, stock prices alone (ignoring dividends) have increased 60 times. (They have increased because earnings have increased roughly 60 times over the same time frame.) It is likely earnings will continue to rise in the future and stocks will follow.

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Sound Bytes...

1. Over shorter time frames, markets are capable of excessive emotional swings. This time isn't different. Over longer time frames, the stock market reflects the underlying economic conditions.
2. Bear markets are as common as dirt. They occur, on average, every five years. This also means stocks increase four out of every five years.
3. The bear market is a temporary interruption of an ongoing and seemingly permanent increase.
4. Volatility is the driver of equity returns over time.

Insurance Products Offered By Fleming Watson Financial Services, LLC

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Maplewood Investment Advisors, Inc.
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Advisory Services Offered Through
MIAI, Inc.

Important Information about Investing and Risk
The S&P 500, S&P 400 Mid Cap, S&P 600 Small Cap, NASDAQ Composite, Dow Jones Industrial Average, Lehman Brothers Aggregate Bond index, and MSCI EAFE index are unmanaged indexes. An investment cannot be made directly in an index. Past performance is not indicative of future results. Investing in any asset class involves the potential of losing money. All risks should be considered before making an investment decision.

To Our Clients and Friends,

As much as we would like to think we, as humans, are capable of making major financial decisions absent of any emotions, it is impossible for us to do so. The money we have accumulated has been the result of hard work, personal sacrifice, or perhaps the generosity of someone for whom we cared deeply. The reasons we try to accumulate wealth also show our emotional bonds. We save to make sure the ones we care for have the things they need. We save to make sure our lives can be enjoyed when work is "optional" (traditionally known as retirement). We prepare so when something happens to us, the ones we love can maintain their standard of living.

The emotional connection we have to the financial aspects of our lives can be our greatest ally while concurrently being our biggest enemy. The same bonds which inspire us to plan for the future also heavily influence our decision making process.

When the market goes down substantially, it is difficult. When the news is bad, there is a natural (and biological) tendency to want to make decision to protect what we have worked and sacrificed to accumulate. It can be even more distressing when you see "nothing" is being done to mitigate the losses in the wake of current market conditions. It is important to understand doing nothing is a proactive and prudent decision.

Right now, our economy is facing some very significant difficulties. The reasons behind the current problems vary and are extremely complex. The challenges facing policy makers and elected officials to correct some of the errors which led us to this point are significant. We do not pretend to know, nor can we predict what will happen next. What we can tell you is this:

We have been and will continue to be believers that a "buy and hold" investment strategy is far better than trying to guess where the tops and bottoms of the stock market will occur. Over time investments have out performed investors through all types and degrees of market cycles. Until someone develops an accurate and flawless system which predicts the high and low points, we fail to see a better methodology.

Our money remains invested in the same ideas we use for our clients. Our emotional ties to the money are very similar to yours. We do not enjoy seeing our own accounts decrease in value any more than you do, but we are staying the course and feel you should do the same.

We have the utmost faith equities will behave just as they always have and provide us the opportunities to earn returns which will significantly outpace inflation over time.

Together we have faced the most significant bear market since the great depression (2000-2002). We all recovered from that episode, and we believe we will recover fully from this one.

Sincerely,

Jim and Neal.

"I have no idea what the stock market is going to do next month or six months from now," Warren Buffett told CNBC on Friday (October 10th, 2008). "I do know that the American economy, over a period of time, will do very well, and people who own a piece of it will do well."

HISTORICAL PERSPECTIVE

In order to have a better understanding of what we may experience, it is often important to understand where we have been. History can tell us what can potentially happen. While this chart omits a couple of less significant bear markets (1998, for one) it does provide some perspective on the stock market as a whole.

						Returns after trough (%)		
Peak	Trough	Recovery	Total Decline	# of Months Peak to Trough	# of Months to recover	1 Month After	3 Months After	6 Months After
Jun-48	Jun-49	Jan-50	-20.60%	12	7			
Aug-56	Oct-57	Sep-58	-21.60%	15	11	5%	6%	10%
Dec-61	Jun-62	Jun-63	-28.00%	7	12	9%	7%	20%
Feb-66	Oct-66	May-67	-22.20%	8	7	10%	13%	22%
Dec-68	May-70	Mar-72	-36.10%	18	22	6%	17%	24%
Jan-73	Oct-74	Jul-80	-48.20%	21	70	17%	14%	31%
Dec-80	Aug-82	Nov-82	-27.10%	21	3	19%	36%	45%
Aug-87	Dec-87	Jul-89	-33.50%	3	20	14%	19%	19%
Mar-00	Oct-02	May-07	-49.10%	31	56	13%	19%	11%
Oct-07	7-Oct-08	??	-36.40%	12*	??	??	??	??

What can we learn from the information above? First and foremost, in the nine prior examples of bear markets, each time the market has gone on to fully and completely recover from its downturn. We can also see the returns immediately following the bottom of the market cycle have been significant and are extremely critical to regaining the ground you have lost during the decline.

We can also see that the declines have been erratic and unpredictable. Their duration has varied greatly (from three months to almost six years). It tells us we really will not know how far the market will go down nor how long it will take to recover.

We do not know if we have reached the bottom in the current bear market cycle, and we will not know until the recovery is well under way. Imagine though how much longer it will take to recover if you fail to participate in the larger returns which typically immediately follow the bottom.

POLITICS

During an election year, people always wonder what the impact of the election may have on the stock market and, in turn their investment portfolios. This election has been made to appear to be more important and more critical largely because of the current economic and financial situations we face. History will eventually be the judge of this elections importance.

There is a significant "time lag" from the time an official is elected and the economic impact felt from any policies he or she is enable to enact. Governments rarely move quickly on any matter, and the economic impact will not usually be felt for an even longer period.

Perhaps one of the worst side effects of the political process is the continuous bombardment of bad news. Each side is stressing how bad things are and pointing the finger at the other party so they can gain an advantage in the polls.

It is our hope, once the elections conclude in November, the alarmist rhetoric subsides, and the elected officials go to work addressing the challenges they have before them.

REQUIRED MINIMUM DISTRIBUTIONS

For those who have attained age 70 1/2 you are now required to take required minimum distributions from your IRAs and other qualified accounts before the end of the year.

For the accounts you have with us, we are in the process of sending you the necessary forms to process your withdrawal. If you have other accounts, you need to make sure your distributions are processed before the end of the year.

Failure to take the required minimum amount results in a substantial income tax penalty-50% of the shortfall.

You may take more than the minimum amount if you desire. You also do not have to liquidate investments to satisfy your distribution requirement. You may simply re-register shares to a personal or joint account (please remember, the distribution is taxable).

If you have any questions, please do not hesitate to give us a call at 373-4877 or (800) 860-4871.

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Truth #4: Volatility is the reason for the superior returns of equities over time. Can you imagine bonds going *up or down* 20% in a year's time? It doesn't happen. With equities it happens all of the time! We never know from one day or one year to the next what equities are going to do. It is one of the reasons they have been able to command superior returns over cash and bonds. The investors demand it!

In fact, over time stocks have generated real returns (return after inflation) three times greater than bonds. While the most significant financial risk we face is the loss of purchasing power due to inflation, it is important to rely on the wealth building power equities provide.

Yes times are difficult right now, but it really isn't fundamentally different than any time before. We should be so lucky to see equities act just as they always have. Those with patience and perserverance will be rewarded.

Homeowners who do not itemize deductions can claim an additional standard deduction for state and local real estate taxes. The additional standard deduction is the lesser of actual taxes paid or $500 ($1,000 for joint returns). This break only applies for 2008 and there is no income limit.

The consensus of economists has forecast nine of the last three recessions.

-Paul Samuelson

More money has been lost by people trying to anticipate and avoide bear markets than in all the bear markets themselves.

-Peter Lynch

"Buy and Hold" is the worst equity investment strategy ever devised by man...Except for all the others.

-Nick Murray

History does not repeat itself exactly-But behavior does

-Bob Farrell

BY THE NUMBERS

8.79...
Percentage decline of the S&P 500 on September 29, 2008. A day which does not rank in the top twenty of all one day declines in stock market history. (Leuthhold Group)

14...
Days when the S&P 500 moved 1% or more in the month of September. Ten of which moved more than 2%, eight of which moved more than 3%. (Leuthold Group)

18...
Average duration, in months, of S&P 500 Bear Markets since 1929. (Leuthold Group)

970.43...
Price of the S&P 500 on Dec. 31, 1997, roughly the same price as of this writing-October 9, 2008 (Standard and Poors)

49...
Percentage growth in earnings per share of the S&P 500 from December 31, 1997 through 2008 (Standard and Poors)

88...
Percentage increase in dividend per share income (Dec 31, 1997 vs. Sept 30, 2008) of the S&P 500. (Standard and Poors)

2.97...
Current Earnings Yield of the S&P 500 (Standard and Poors)

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