

Review for 2008 and 2009 Future Outlook

The worst on record since 1931

Last year marked the worst performance of the Dow Jones Industrial Average since 1931. In 2008 the average declined 38.5% and to many investors it seemed like a scary movie with no end in sight. It's a strange coincidence that 1931 had three classic scary movies as top grossing films: *Dr Jekyll and Mr. Hyde*, *Frankenstein* (starring Boris Karloff) and *Dracula* (starring Bela Lugosi).

While 1931 and 2008 will both be remembered in U.S. history for financial hardship, it is also noteworthy to mention that they both ushered in tremendous change upon the political landscape – with the election of Franklin Roosevelt and Barack Obama.

For those of you who appreciate U.S. history, 1931 is also noteworthy for other important events: Thomas Edison submits his last patent application; The Star-Spangled Banner is adopted as the U.S. National Anthem; Nevada legalizes gambling; Construction of the Empire State Building is completed; American gangster Al Capone is sentenced to 11 years in prison for tax evasion; And in sports, the St Louis Cardinals beat the Philadelphia Athletics in seven games to win the 1931 World Series.

A year of surprises

In all seriousness, 2008 was especially noteworthy due to the passing of some corporate giants. Gone are Bear Stearns, Lehman Brothers and the traditional independent investment banking business model. Merrill Lynch was sold to Bank of America and the remaining two investment banks – Goldman Sachs and Morgan Stanley – changed their charters to become independent commercial banks.

Other institutions that failed or were forced to be acquired in 2008 were: Indymac Bank, Fannie Mae, Freddie Mac, Washington Mutual and Wachovia. In addition, the U.S Government provided financing for insurer AIG and automakers General Motors and Chrysler so they could continue their operations. Finally, the Federal Reserve cut their interest rate target to an astounding 0.00%.

Another failure we were saddened to witness last year was during Super Bowl XLII when the NY Giants upset the undefeated New England Patriots 17-14. Thankfully, government intervention had nothing to do with that event.

Our outlook: cautiously optimistic

The current economic recession began in December, 2007. In the near term it is likely that the economy will continue to contract and the current recession will last well into 2009. However, it is not unusual for stocks to move higher before a recession officially ends. There are also deflationary risks and declining consumer confidence that will impact the economy and eventual recovery.

We believe that the many efforts by the Treasury Department and the Federal Reserve will help cushion the damage to the U.S. economy. Many of these programs were announced in the final months of 2008 and are only starting to get off the ground.

We also witnessed unprecedented moves by the Federal Reserve and Treasury to commit billions of dollars in their attempt to restore order to the credit markets. The credit markets are the lifeline of the economy and it is critical they function properly. We believe that these efforts will succeed.

Additionally it appears likely that the new Obama administration will push for a new – and larger – stimulus package combining infrastructure projects, aid to state and local governments, and targeted tax cuts. While economic medicine can always have side effects, we believe that the government stimulus combined with actions of the Federal Reserve and Treasury will eventually take hold and show results.

No place to hide – but we still recommend diversification

What set 2008 apart from other market sell offs was that there was no place to hide and diversification did little to shield investors from the sharp declines. We still believe that a diversified portfolio is the best way to achieve your goals and minimize risk but 2008 brought a new threat: systematic risk. Many investors were concerned about systematic risk, or put another way – there was concern that the entire financial system could collapse. This new element of risk affected virtually every investment category – stocks and bonds alike. We believe that the proactive policies of the U.S. Government have successfully averted the possible worse case scenarios and will aid in the recovery.

Credit markets led stocks lower – but we see value

The credit markets were the driving force in turning stocks and the economy lower in 2008. Prices of corporate and mortgage bonds sank to new lows. Even municipal bonds, traditionally the safest bond issues, saw price declines as investors were concerned about state budget deficits, recession and the viability of private bond insurers.

As a result, many investors flocked to Treasury bonds and their prices skyrocketed making these investments by far the best performing asset class for the year. As an example of widespread caution, some investors bought short-term T-bills at a yield of 0%, just for the assurance they will get their money back when the issues mature.

We now see tremendous value in the corporate and municipal bond markets. Many of our portfolios contain these securities and we are confident that the price disparities will self correct. In addition, we believe the Federal Reserve's program to support money market funds and purchase short term commercial paper was helpful in unfreezing the lending markets.

Real estate, commodities and world Markets

According to the S&P Case Schiller Home Price Index, housing prices fell 23% in 2008. We anticipate troubles in the housing market to continue but government efforts to stem foreclosures and maintain low interest rates will expedite the healing process.

Can you say bubble? The action in the commodity markets was a classic boom-to-bust cycle. After showing tremendous gains in the first half of the year, The Dow Jones AIG Commodity Index finished with a loss of 37%. Most notable was the price decline of oil falling 54% for the year to \$44.60 a barrel – down from the summer high of \$145.29 a barrel.

World stock markets suffered a similar fate as U.S. markets and it soon became clear that no economy would emerge unscathed. The Dow Jones Stoxx Index of Europe's 600 largest companies fell 46% and the MSCI Asia-Pacific Index fell 53.3%. The benchmark Shanghai Composite Index dropped 65.4% putting the brakes on one of the best performing world markets. We think the good news is that it is unlikely these markets will repeat similarly bad back-to-back performances.

Did you know?

The IRS has allowed more than one investment change for 529 Plans during the current calendar year. As of this writing, the change is applicable only to calendar year 2009.

Additionally, if you are currently required to take minimum distributions from your IRA, the government has suspended this requirement from certain retirement accounts for 2009. Please contact us to learn more about these important changes.

New Year's resolution: Have a plan!

Now is the time to evaluate your financial health, set financial goals or establish a detailed plan for retirement. We offer *comprehensive financial planning* and targeted plans to address a specific goal. We are dedicated to providing you with independent, objective, professional advice customized to meet your specified needs. Our financial planning process starts with an initial exploration meeting, offered free of charge, to discuss how our services can match your needs.

We are here for you

Please contact us if you have any questions, if you'd like to schedule an account review or learn more about our comprehensive financial planning services. If you already have a plan we recommend you check in with us so we can monitor your progress or make changes if needed. You can also visit our website at www.carlpsherr.com to learn more about all of our services. Our website also features reprints of past newsletters, 'in the news' articles featuring our team members...and so much more.