

# Market Update

June 6, 2008



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## Muddling Along

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The 2008 Memorial Golf Tournament held in Dublin, Ohio had great weather – mostly sunshine and dry conditions. Golfers were greeted with “lightning” fast greens and very tall rough, making the 4-day tournament unlike many in the past. As most central Ohio residents and fans know, the weather for this tournament is often rainy and the golf course extremely wet, even muddy. We even joke in May and June when it rains too much, the Memorial tournament must be in town, or the Leatherlips course continues.

The U.S. economy appears to be muddling along; potentially stuck in the mud that will not produce a recession or a recovery. The economy does not appear very vibrant. Forecasts call for slow, slow growth. Worries abound for investors: bank and real estate loan problems, declining real estate values, rising inflation (particularly in oil/gas, food and commodities), and a low dollar trade value. House prices are down and stock prices are still below where they ended 2007. The prospects appear to suggest a slow growth economic environment with worrisome inflation for the next couple of years. And, if the U.S. economic outlook looks soft and inflationary, the world economic outlook seems to be muddling down as well. After all, anytime the financial structure is de-leveraging, it takes a while to complete the process.

May proved to be a continuation of the April stock rally (actually began March 17, St. Patrick’s Day when Bear Stearns was bought by JPMorgan/Chase). The average diversified U.S. stock fund advanced almost 3% during May, while the S&P 500 rose about 1.3%. Foreign stocks advanced at a slower pace gaining about 1.7%. Most all bond categories lost value as investors sold bonds (to cautiously buy stocks) and inflation worries increased.

|              | Month | 3 Months | YTD   |
|--------------|-------|----------|-------|
| Small Growth | 4.9%  | 8.8%     | -5.7% |
| Mid Growth   | 4.5%  | 9.5%     | -2.4% |
| Small Value  | 4.2%  | 8.1%     | 0.2%  |
| Mid Value    | 3.8%  | 7.6%     | -0.5% |
| Large Growth | 3.0%  | 8.3%     | -3.6% |
| Foreign      | 1.7%  | 5.5%     | -3.3% |
| S&P 500      | 1.3%  | 5.7%     | -4.6% |
| Large Value  | 0.7%  | 4.1%     | -4.5% |

All stock categories still sport a loss of value for the first 5 months of 2008. Client portfolios advanced for all investment objectives during May, and have encouraging returns during the rally (since March 17). Values in general are still below year-end as we are not yet out of the correction that is now 8 months old (since October 2007).

A new bull market has not started; the current correction is still underway (but portfolio values have been on the rise with the current 2-month rally). New bull markets exhibit a few characteristics not currently in place: 1. A big increase in trading volume (trading volume has been soft and low); 2. Increased risk taking (investors who are investing cash are currently buying close to the index, called index hugging - they are not taking on new risk); 3. New leadership replaces old leaders (new bull markets reveal new leaders – leadership in this market remains unchanged). There is no investor conviction that our financial problems are past. Thus, the muddling along scenario appears likely to remain for a while.

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*Continued on page 2*



### Muddling Along (continued)

So why is the stock market rallying when the economy is muddling and inflation appears to be a problem? Slow progress is occurring and more is anticipated. De-leveraging is slowing economic growth and foreign economies are showing signs of slowing growth as well. These trends will further cause commodities and oil prices to begin to slide. Slowing world economic growth should also cause inflation to wane and foreign bankers should begin to lower their interest rates. As foreign interest rates and commodity prices dip, the U.S. dollar should rise (strengthen); and the cycle continues. Evidence is starting to appear. Agricultural commodities have declined 25% from their peak of recent; industrial metals have slid 19%, precious metals are down 15%, and energy has eased 8%. The U.S. dollar has risen 4% against the Euro, 7% versus the British Pound, and 8% compared the Japanese Yen. Did we mention the Chinese stock market is 50% lower; most likely signifying a slower economic outlook? Thus a rising dollar and declining commodity prices will help alleviate inflation pressures. As these things slowly come to pass, stocks should resume their rally with higher values.

While we do not expect a recession, and a recovery does not appear imminent, a muddle along experience seems likely for a while. We do see beginnings of new days that could initiate a new bull market in stocks. Thus, we remain long-term advocates of time-in the market investing.

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