

Market Update

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Bubble, Bubble! Is Oil In Trouble?

By Bill Henderly, CFA, Nvest Wealth Strategies, Inc.

The financial markets are caught with competitive issues: inflation, slow growth, and credit markets in disrepair. The question every investor is asking, "Should we change what we are doing?" Should we be invested more conservatively?" Clients are saying "everything we see suggests a lot of uncertainty and pain." A counter question we pose, "Has anything changed with your original plan (investment objective) wherein a new plan is now appropriate?"

We are in the midst of the worst financial crisis since the 1930s. In many ways it resembles other crises that have occurred in the past 25 years, but there is a profound difference. The current crisis is global and is washing out the pursuit of leveraged (borrowed money) investing. Or shall we call it speculating?!

The Federal Reserve has aggressively addressed two issues: a frozen credit market (difficult for businesses and individuals to borrow), and a slowing economy. The Fed has lowered interest rates from 5.25% to 2% in six months. Despite these actions, a growth risk still remains. At the same time, inflation poses a "significant concern" and its outlook remains "highly uncertain". The Fed expects inflation to lessen, but thus far it has been stubborn. Stock vigilantes have been battling oil (and commodity) speculators. Since July 14, oil has declined over 20% from \$147/barrel to \$115/barrel. Oil's price bubble is in trouble because US and worldwide demand is sliding due to too high prices. The transition will not be quick; Rome was not built in a day; and, battleships do not turn on a dime.

July was another month of stock value declines. Portfolios generally slipped more than the S&P500. This has been an atypical experience, as heretofore portfolio values have slipped less than the markets. I have observed that portfolio values tend to lag the markets by a couple of weeks; continuing to rise after the market peaks, and continuing to slide after the market bottoms. Stock mutual funds rode a roller coaster in July, ending mostly lower. Performance of different style funds was quite varied. Short Treasury notes did okay while longer maturity and corporate bonds struggled.

	July	YTD
Small Value	2.3%	-6.6%
Small Growth	-0.7%	-12.4%
S&P 500	-0.9%	-12.9%
Large Value	-1.1%	-14.0%
Mid Value	-1.3%	-10.5%
Large Growth	-2.3%	-12.3%
Mid Growth	-3.7%	-11.9%
Foreign	-3.8%	-15.1%

We do not need good news for stocks to rally. The markets often rally in the midst of bad news – recently news was *less* bad than expected. On March 17 we rallied for 6 weeks when Bear Stearns collapsed (JP Morgan bought them); since July 15 a small rally has developed as stock vigilantes beat on oil speculators; and the US dollar has been rallying as the US appears to not be slowing as much as other parts of the world. We will see more attempts to rally before this bear market ends. The final rally will appear like others, but it will ultimately be the start of a new bull market. As Warren Buffett recently stated, "In the [investment] world, the rearview mirror is always clearer than the windshield." Others have said.....

"History will teach you that, first, we have seen all of this before; whether it's bubbles or panics or collapses. And yet, somehow, the world adapts. It also shows that whatever we are seeing today is not going to be true in 10 years, as was the case with the technology bubble." Jim Rogers, Barron's April 2008.

CONTACT US:

2310 Home Road
 Delaware, Ohio 43015
 740.917.9234

WWW.NVESTWEALTH.COM
 Email: info@investwealth.com

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“Successful investors must endure the short-term vagaries of market declines to be positioned well for the long term.” Mason Hawkins, Longleaf Partners letter to shareholders, March 2008.

We view stocks as priced to outperform bonds over most 5-year scenarios. Big market downturns invariably present opportunities, and without them, we would not have enjoyed the opportunity to beat the markets over the past 14 years. In this type of environment, a sense of perspective and a reliance on our investment discipline helps us avoid becoming panicked by short-term concerns and paralyzed by longer-term uncertainty. The markets will do better as 1. confidence returns to the financial sector and 2. oil bursts its bubble. We do not know the exact timing for the end of this storm, but do see progress toward its end.

We believe strongly in the idea of retaining a long term investment perspective – it is crucial for growing personal wealth and determining the success of an investment approach. Flourishing in an up market is wonderful. Surviving a bear market by losing less is at least as good. However, the time test is performance over full market cycles, which include both up and down market intervals. If this bear market is getting you down, we should meet, at a minimum to verify that your original plan is still appropriate.

Check our website nvestwealth.com regularly for weekly updates on the markets.



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Chris Britt
State Journal-Register, Springfield, Ill.
Copley News Service

CONTACT US:

2310 Home Road
Delaware, Ohio 43015
740.917.9234

WWW.NVESTWEALTH.COM
Email: info@nvestwealth.com