

OCTOBER'S HORRIFIC TRICK

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Schwab Statement Alert: Anticipate a worst-look slide in portfolio values on your October statements. Market declines were steep and wide; even tame investments were pummeled.

October 2008 was one of the most stressful months in US stock market history. On October 10, the Dow Jones Industrial Average and other stock indices collapsed, bringing the average down 41% from year-end and down 45% from its peak in October 2007 (the average bear market falls 35%). It was a historic meltdown.

	October	YTD
S&P 500	-16.8%	-33.1%
Large Value	-17.0%	-33.7%
Large Growth	-17.2%	-36.1%
Small Value	-20.6%	-28.8%
Mid Growth	-20.6%	-39.7%
Small Growth	-21.0%	-31.7%
Mid Value	-21.2%	-35.4%
Foreign	-21.7%	-44.6%

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Stocks in general experienced their worst monthly point drop, and one of their biggest percentage declines in 57 years; it was the second worst performance month ever. Trading was extremely volatile; we also experienced two of the biggest single day point gains on October 13 (+936 points or +11.6%) and October 28 (+889 points or +10.9%). Several rally days helped to moderate the horrific month. Even safe bonds were not immune, reporting losses of -0.5% to over -5% for various maturities of government paper.

October, as a month, seemed like a full year of activity. So rapid and extensive was the negative news and events – it was like “dominos” falling faster and bigger with each day. And policy response by the Fed and Treasury was equally huge and unprecedented. Abysmal and Unbelievable!

Mark Twain’s famous quote, “History does not repeat itself, but it rhymes” seems very appropriate in 2008. Investors are attempting to compare 2008 to 1987, to 1974, or to the 1930’s. But each bear market has its own peculiarities that are unique. This one does not compare to 1929 and 1930’s (despite the hugeness of the decline) in that government is very responsive with its policy actions. Policy response usually works but with a lag, on the markets. Even now, investor focus is shifting from frozen credit markets to recession worries (How bad will a recession be, and how long will it last?).

Have we seen capitulation? Market lows are not necessarily marked by tidal waves of frantic selling (October 10). It is often more difficult to define or pinpoint. Stocks bottom in a dull and lonely atmosphere as trading volume dries up and most investors no longer care. Bear markets often end in a cloud of indifference, not a crescendo of selling. At the bottom, most investors are not even ringside.

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OCTOBER'S HORRIFIC TRICK (CONTINUED)

What are we doing? As stock values have been slaughtered, their exposure in client portfolios are at percentage lows. At the same time, bond exposure has risen as a percent of total (if the objective was 35% bonds, its exposure was close to 44% as stocks sold off). Bonds (our safe haven along with cash) are an expensive asset relative to stocks. At month-end, we redeemed some exposure to bonds, pulling their allocation back in line with portfolio objectives. When the stock market ultimately rallies, high quality bonds will sell off. We also reduced exposure to foreign and other sector funds (technology and real estate). While all are very cheap, maintaining a focus on the basics is important. The recent 16% rally in the value of the US dollar is implying that foreigners have more confidence in the US policy response and financial system (even if we created this world financial mess). It suggests the recovery for foreign investments will be even slower in occurring; that domestic recovery will be earlier. We will slowly deploy cash reserves (now 15% to 25% of portfolios) back into basic stock mutual funds – emphasizing a style neutral exposure to small and mid-size stocks (with higher domestic sales exposure); large cap stocks will be slightly reduced as they too have foreign sales exposures. Bond allocations incorporate broader diversification focused on short and intermediate good quality funds. Portfolios are invested conservatively, but we are looking opportunistically.

Warren Buffett stated on October 17, “be greedy when others are fearful, and be fearful when others are greedy.” It certainly seems like everyone is fearful. “If you wait for the robins, spring will be over.” Does it feel like you are shopping on the day after Christmas and all merchandise is 45% off? We find the markets looking very attractive; but we are looking with caution and care.

We do not know when the bottom will occur. It may have occurred on October 10. Only hindsight will reveal its exact date. We do expect further testing of recent lows and that the recovery of values will be drawn out. The recovery in values will not be in a “V” or “W” pattern; it will probably be more like a long drawn-out “U”. We do know that recent events have created major uncertainty, and major uncertainty usually brings major opportunity. You too should be looking forward with anticipation – most basic investments are reaching unbelievable values we will likely not see again for a long time.

Come enjoy WildLights at the Columbus Zoo on Thursday, December 11 compliments of Nvest Wealth Strategies, and warm up in our hospitality room with holiday treats!

Clients, please RSVP to steve@nvestwealth.com if you would like to attend.

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