

BEACON INVESTMENT MANAGEMENT

THE FRIDAY BRIEF

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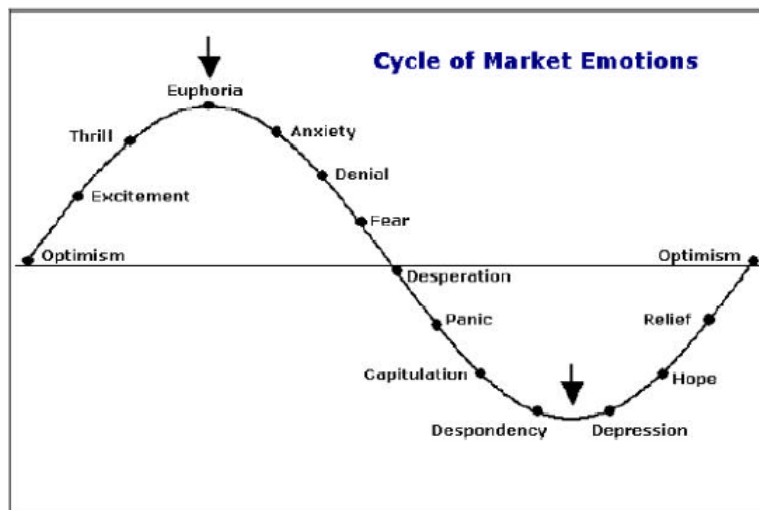
Toll Free 888-621-5885

Friday, October 10, 2008

A Fireside Chat

News continues worsen in financial markets throughout the world. No economy is free from the carnage with more than \$25 trillion erased from global equities in 2008. The Dow Jones Industrials index is now down more than 43% from its record high a year ago. This week represents the worst for the S&P 500 since 1933.

Major moves by our government and those of others, even unprecedented concerted efforts have had little effect so far in stemming the raging destruction of trust and confidence. In an email sent late yesterday I discussed how much it looked like the market was entering a stage of capitulation where investors give up and sell out. During my morning devotional as I was praying and thinking about the Brief this morning, I remembered that I had buried somewhere in my files a pictorial chart of the market cycle from back in 1987. I remembered that it did a good job of portraying the many emotions investors experience and where they fall along a definite and predictable pattern. I wish I could credit the source, but only the image remained.



When I viewed the chart, my eyes first glance was on the dip. I wondered where we are now on the misery part of the curve. If we are near capitulation as posited by my email yesterday, then we are very near the bottom. I can tell you that I found myself locked almost in a trance this morning as I watched yet another down opening with the rapidly flickering red lights on my screen. How much longer will this madness go on I asked my computer?

It is surely possible that we are still up the curve a little and have not yet reached capitulation. Commodity and stock markets no longer seem to value the logic of fundamentals. The price to earnings ratio (a measure of value) of the S&P 500 is approaching 10 times, the cheapest market valuations since 1985 – two years BEFORE the crash. Crude oil for November delivery fell as much as \$5.46, or 6.3% this morning to \$81.13. Copper slumped in London, set for its

worst week in more than two decades. "We have reached the panic stage," said Espen Furnes, an Oslo-based fund manager. "This is worse than 1987 because then it was largely confined to the stock market, with limited effects on the underlying economy. Fundamentals don't count anymore." Jim Rogers, chairman of a Singapore-based money manager said "it's very clearly a crash, people are selling everything no matter what the fundamentals. Its forced liquidation."

'Panic', 'capitulation', 'despondency;' the lines between them are blurred. As we get closer to a market bottom, it's becoming clear that we know very little about what to expect. This time seems very different. This bottom will likely be soft and murky, lacking the qualities necessary for a quick bounce, at least in the near future. But, that's the way I felt back in 1987 and in 2000-2003 as well. It felt as though the world was coming to an end those times too.

Eventually sellers will have sold everything they need to sell. Some will never come back to the markets; others will be content for a time with money market and T-bill rates at 1%. But the majority of sellers will eventually grow weary of low returns on their money available through alternatives to stocks and they will gradually come back to the market. As they do, prices will rise gently on the new buy orders. The rising prices will attract other buyers and the media and soon, we will once again find ourselves on the up cycle of 'hope', 'relief' and 'optimism.'

The bounce could be days, weeks, or months away. I expect, given the massive dislocation of trust, we are in for a protracted series of fits and starts. There may not be a moment of turn or a definitive bounce, but rather a period of re-building the foundation before a significant takeoff. The number and extent of negative developments should diminish and be replaced by gradually strengthening signs of improvement.

Much is being done by our government, those around the world, and throughout the massive private sector to reverse the crisis. President Bush speaking in the Rose Garden this morning said "The plan we are executing is aggressive. It is the right plan. It will take time to have its full impact. It is flexible enough to adapt as the situation changes and it is big enough to work."

In his article in the WSJ today Paul Volker said "The inevitable recession can be moderated. The groundwork can be laid for reconstructing the financial system and the regulatory and supervisory arrangements from the bottom up. The extraordinary interventions by the government (and taxpayer) should be ended as soon as reasonably feasible. There is, and must be, recognition of the essential role that free and competitive financial markets play in a vigorous, innovative economic system. There needs to be understanding, in that context, that financial ups and downs -- and financial crises -- will be inevitable, even with responsible economic policies and sensible regulation. But never again should so much economic damage be risked by a financial structure so fragile, so overextended, so opaque as that of recent years.

The US and the global economies will come through this crisis just as with tech bubble, 9/11, corporate scandals (i.e. Enron), the Asian Contagion, Long-Term Capital, and even the lost decades of the 1930's and the 1970's. Our common need for international cooperation, lessons learned from the past, and benefits of the Information Age offering better, faster, more adaptive systems will all work together to bring this crisis to as hasty an end as possible. Perhaps a stronger, more efficient and transparent global economy will result.

As markets close this weekend, we hope reason and wisdom find their way back into fray.