

First Quarter 2008

During the first quarter of 2008, we witnessed a continued decline of the stock market. By mid-March, the Dow was down 11% year to date and 17% off its high in October 2007. As of this writing, the index has recovered a bit and is now down 7% since year end. The downturn has hit all sectors including large and small U.S. equities, as well as international equities. Bonds had a positive quarter, posting low single digit returns.

Market volatility has been on the rise. For the first quarter, the S&P 500 moved more than 1% in either direction on 50% of the trading days, up from 26% in 2007 and 21% over the past 46 years. Volatility is still 50% below what it was in 2003 around the start of the war in Iraq, however, we seem to notice it more now as we have had unusually low volatility levels over the past 3 years. It should be noted that during years of above average volatility, returns have been above and below average in an equal number of years so increased volatility is not necessarily indicative of below average performance.

In the news we have been barraged by many stories – continued credit crunch and liquidity issues in the financial system, subprime mortgage mess, declining housing prices, writeoffs in the financial sector, a declining dollar, increasing oil prices, and recession fears. A recession is technically defined as two consecutive quarters of negative GDP growth. The growth was minimally positive in the 4th quarter of 2007 so there is not yet any official label of recession. It is clear, however, that the U.S. economy is experiencing difficult times and many believe we are headed in that direction. It is interesting to note that the average recession lasts less than one year.

With the bad news and increased volatility we have experienced over the past two quarters, it is perhaps helpful to look back at the past decade. Ten years ago very few people predicted the stock market bubble that followed the currency crisis and lasted through March 2000. The market bottomed out in October 2002 and volatility doubled as the Iraq war broke out in March 2003. At that time, the S & P 500 Index stood at 876. Today, it is at 1,333, up approximately 52%. It is hard to imagine that we were talking about positive signs five years ago with the war breaking out and we were only 18 months removed from the terrorist attacks and six months removed from the bottom of the bear market. So while it is once again hard to sit here and see the positives, the long term trend of the stock market is up. My sense is that one day we will look back at this period and see that it was a good buying opportunity.

Everyone wants to know when we will hit bottom and, of course, no one knows for sure. The effects of Fed moves usually lag by 6 – 9 months. Many market analysts are predicting more bumps in the road through 2008 with signs of improvement after that. Patience is necessary here. In the volatile markets we are experiencing today, the key to successful long-term investing is to maintain a diversified portfolio with an appropriate level of risk commensurate with your goals, time horizon and level of risk tolerance. There is no free lunch here. In order to achieve the long term returns of equities, one must understand that there will be periods of downturns. Remember that investments such as CDs and money markets may have no risk of principal loss but they do have the long term risk of not keeping up with inflation.

Enclosed please find your report for the quarter ended March 31, 2008. As always, do not hesitate to call me if you have any questions or concerns. Enjoy Spring – it is finally here!

