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IS CHICKEN LITTLE RIGHT?

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To Our Friends and Investors:

During my 38 years in the investment business, I have endured, seen and experienced a number of stock market crises and panics. (All of which, at the time, seemed to be the end of the investment world. Plus, feelings abound that stocks would never go "up" again.)

Over the past 103 years, we have had 33 bear markets. The average length of time from top to bottom is 14 months and the average decline is 31%. This bear market has lasted 17 months, if you use June '07 as the peak of the average stock or 13 months if you use the peak of the S&P 500 stock index. To date, the decline from peak to trough of the current bear market, using the S&P 500, is 52% (as of November 20, 2008).

Recalling some of the previous bear markets, the 1973 – 1974 market fell 48% (S&P 500) and ended in the midst of a gas crisis, a President resigning ("Therefore, I shall resign the Presidency effective noon tomorrow" ...Richard Nixon August 8, 1974), a real estate downturn, and a recession. The 1980 – 1982 market declined 27% and terminated with economic stagflation (I recall the headlines in Business Week magazine saying "Growth in America has come to a permanent halt.") and short-term interest rates that peaked at 22% (30 day CD rates at the First National Bank of Atlanta and mortgage rates for homes were over 10%, if you could qualify). The 1987 bear market presented us with a decline of 34%. During a single day, October 19, 1987, the market dropped about 22% from open to close. That 22% decline was twice as much as we have seen on any single day this time around. The market bottomed out during great concerns about the stability of the economy. The 1990 market decline of 20%, although relatively mild in comparison with today, occurred during a time of a nationwide collapse of the savings and loan industry, a real estate downturn and an economic recession. (Sound familiar!?) Then the 2000 – 2002 dot com internet bubble created a market that declined 49%. (Remember the fear and uncertainty of just a few years ago?)

During each of these bear markets investor anxiety, despondency, depression and fear were at maximum levels. These characteristics seem to historically correlate with major market bottoms. These emotions are natural and expected since one has been constantly bombarded by the negative press for months on end with nothing but bad news and declining stock portfolios. (By the way, has anyone heard the press state that the recent decline in gas prices is estimated to have a positive economic impact that equates to a $250 billion dollar tax cut?)

(over)

What do we see as we look at the present market and its conditions?

1. Since World War II, the current decline (-52%) is one of the three largest on record. The other two were 2000 – 2002 (-49%) and 1973 – 1974 (-48%).

2. The current decline (-52%) is far greater than the average over the last 100+ years (-31%).

3. The length of time to create the current decline is equal to or greater in months than the average (14 months).

4. In our view, the liquidity crisis (which began with the collapse of Lehman Brothers) is the major reason for the market decline since mid-September. Yet we believe the crisis has peaked and now is slowly easing (worldwide) as a result of multiple positive steps.

5. Our market indicators are in a position that has strongly correlated to past market bottoms and the beginning of bull markets.

6. We expect additional fiscal stimulus programs to come from the government that will help stem the slide in economic activity.

7. Today's stock market valuation benchmarks (Price to Earnings ratio, Price to Sales ratio, Price to Book Value ratio, Price to Cash Flow ratio) are quite attractive and are in one of the historically most undervalued areas.

8. Bear markets end when fear and depression are paramount and capitulation selling is present along with high volatility from forced sellers (i.e. mutual fund redemptions).

Let's take a look at market performance following bear markets over the past 35 years. Markets are up an average 36% in the first 12 months.

Bear Market	6 months	1 year	2 years
1973 – 1974	31%	38%	66%
1980 – 1982	44%	58%	62%
1987	19%	21%	57%
1990	28%	29%	36%
2000 – 2002	12%	34%	45%
Average	**27%**	**36%**	**53%**

(Source: finance.yahoo.com)

The highly respected Value Line Investment Survey (as of November 21, 2008) projects the median price appreciation potential of stocks is 160% over the next 3 – 5 years. (By the way, at the 2002 market bottom, their projection was 115%. . . the actual return was 102%.)

What are our conclusions from all the work we do?

1. If the current recession lasts twice as long as the average recession since World War II (average recession has been 11 months), then this recession (which the NBER recently stated started in December ‘07) should last until about October ‘09. Considering *the stock market historically turns up about midway into a recession,* that would mean that we are presently very close to that juncture.

2. Now is one of the greatest values in stocks in many, many years.

3. While cash may make an investor comfortable in the short term, odds are that it will be most punishing relative to stock returns in the near and long term. (I remember investors who sold at the market bottom in 1987, stayed in cash for many years and missed huge, huge profits.)

4. This may be an excellent time to increase exposure to stocks and decrease holdings of cash.

5. After a few years, we will all look back at this time and most likely realize that the fall of ’08 was a great time to be an owner/buyer of stocks.

I have just returned from a trip to several cities and visiting with many clients. I am aware of the valid emotions that exist and they are hard ones with which to live. *However, to be a successful investor, one has to focus on what is coming …not on what has passed.* For what help it may be I want to share with you the following statements from three super successful investors.

“To succeed, investors must be greedy when everyone else is fearful. . .
and fearful when everyone else is greedy.” ~Warren Buffet

“Bull markets are born on pessimism, grow in skepticism,
mature in optimism, and die in euphoria.” ~Sir John Templeton

“The opportunity of a lifetime seems to be present. . .There has never before been
a time in our careers when so many high-quality well financed companies have
been available at such large discounts”
~Marty Whitman (age 84) November 13 letter to shareholders.

Best Regards,

Ron H. Bell