

April 8, 2009

The last four weeks have certainly been a good reminder that stocks do not always go down. While we may see another downturn in prices in the near term, there are a number of additional reasons why we think the recent rebound could continue:

- According to Liz Ann Sonders, Chief Investment Strategist at Schwab, “We are seeing notable differences between current market action and that of last fall. The breadth of the sell-off to new lows is much narrower than the broad-based waterfall decline in October and November.”
- The Financial Accounting Standard Board voted last Thursday (April 2) in favor of a proposal that will give institutions more flexibility in how they use fair value, or mark-to-market, accounting rules. This should help the banking industry improve their capital positions.
- It appears the uptick rule for short selling will soon be back in place. The uptick rule was created in the 1930s to protect public companies from illegal “bear-raid” manipulations. The SEC did a study a few years ago and determined the rule was ineffective, but many suggest the study was flawed because it took place during a rising market with low volatility. There is no doubt that the removal of the uptick rule in July 2007 was immediately followed by an unprecedented jump in market volatility. I believe that reinstating the rule will reduce volatility in the markets.

Can stocks continue to rebound, even when the economy continues to struggle? Money manager Louis Navallier posted on his blog that the financial press and television continually make the mistake of equating the current stock market with the current economy. From its peak in 1929, the stock market declined 84% to its low in 1932. Imagine if you had a crystal ball at the 1932 bottom. Herbert Hoover was still president. Roosevelt would not take office until almost a year later, beginning the largest peacetime expansion of the federal government. In March 1933 he would close all the banks in the country to avoid a run on the banks. That same year, unemployment would rise to 25%. By the end of 1935, unemployment is still above 20% and at 19% in 1938. Given these economic statistics, who in their right mind would want to own common stocks? Yet from May 1932 to March 1937, stocks returned over 400% (or 40.89% annually), making this the strongest (almost) five-year period in stock market history.

During times of excessive optimism, people overshoot markets on the high side (due to unrealistic expectations), and during times of extreme fear and panic, people overshoot on the downside. In 2008, people panicked and dumped securities, which I believe set the stage for potentially higher-than-normal rewards for people who hold on. I just wish I could tell you when the higher returns will start—or did they start four weeks ago?

I think one of the best pieces of advice I can give you is to not watch hours and hours of CNBC, MSNBC, Fox News, etc. *The Andy Griffith Show* is much more therapeutic!

Best regards,



Mike Miller, CFP®