Market Comments

October 6, 2008

October 6, 2008, was one of the wildest days on Wall Street ever. At one point, the Dow Jones Industrial Average was down more than 800 points or close to 8%. A late afternoon rally narrowed the decline to 370 points, and the Dow closed at 9,955, its first close below 10,000 since November, 2004. The major U.S. stock indexes finished the day down 25-30% on the year, and are down 28-33% since the all time highs set October 9, 2007.

The heavy selling today was reasonably orderly but extremely intense, and likely driven in large part by hedge funds selling to either meet redemptions and/or offset losses stemming from losing investment positions in other asset classes. There are also mounting fears that the spreading credit problems in the U.S. debt markets could lead to a severe global recession. The U.S credit markets remain extremely difficult, as resources are directed toward de-leveraging, making it difficult for even high quality borrowers to get access to debt capital. Finally, buyers are on strike; even though many stocks appear to be “cheap”, buyers have been conditioned to step aside until stock prices rally. Forced liquidations combined with an absence of buyers equates to rapidly falling prices.

We believe a brief letter to clients is important to convey some big picture thoughts, because events are moving very rapidly.

First, we own securities in client portfolios that we believe will survive the current financial crisis. The vast majority of our debt securities have investment grade credit ratings, and our equity ownership is primarily in companies with strong balance sheets and business models that have been very successful in the past and which we believe will continue to be successful over the long run. We believe that our emphasis on “quality” will pay off over time.

Second, we remain bottom-up in our focus. We will continue to own strong companies with attractive valuation characteristics. That is hard to do when stock prices are dropping rapidly, and the temptation is to equate “falling price” with “bad stock.” Our job is to assess current prices in relation to long term value, and at present, assuming an eventual stabilization in the economy and the markets, followed by recovery, stocks seem very attractively priced. This does not mean that prices cannot go materially lower from current levels before eventually going higher, but it does mean that history strongly argues that investors get paid well for taking on “headline risk” by holding and adding to positions when stock prices are under severe pressure (and valuations are consequently most attractive).

Third, even though we are constructive about equities longer term, we expect that the current environment is likely to be very volatile until the markets begin to see signs of stabilization. Your ability to endure short term price volatility is directly proportionate to your investment horizon. If your time horizon is short (2 years or less), then it may be advisable to raise additional cash. If your horizon is longer than 2 years, then the lower stock prices go from current levels, the more attractive stocks become, and we should be opportunistically adding to equities.

As always, please contact us if you would like to discuss your portfolio or if you would like more detail on our thinking regarding the current tumultuous environment.