



Wealth Managers Group

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March 11, 2008

Dear Investor,

Had enough volatility yet?

Ever since October 9, 2007, Mr. Market has performed rather dismally. Those “in the know” (turn to the CNBC or Bloomberg channel among others to find out who “they” are) say Mr. Market is a predictor of things to come. Based on the past several months we can surmise that Mr. Market is predicting tough times ahead. From the high of October 9, 2007 to March 11, 2008 the DJIA is down about 15.5%, the S&P 500 is negative by about 17.5% and the EAFE (foreign markets) are down about 16%. Bonds (other than US Treasuries) have provided little relief as well. At the other end of the spectrum are commodities such as oil and gold, which have been the asset class and momentum play of choice. Eventually, this too will likely end in a sharp correction as speculators appear to be taking prices to extremes.

On the bright side, the Federal Reserve (The Fed) began lowering interest rates on September 18, 2007. Since then The Fed has lowered rates five times for a total of 2.25%. Typically, it takes about six months for rate cuts to begin to work their magic. Right around now we should begin seeing some of the benefits of these lower rates. Additionally, Congress and the President recently agreed on a stimulus package and many consumers will see checks in the mail come summer. On another positive note, the Global economy seems to be continuing to grow at a good pace in spite of the slowdown in the US economy. Currently, Mr. Market’s valuations are near 18 year lows and interest rates on long-term US Treasuries are near all time historic lows; therefore US Treasury bonds are currently very expensive.

It comes as no surprise that many individual investors hate stocks at this time. Unfortunately, the behavior of such investors is often self destructive. According to a recent article in *Barron’s, The Dow Jones Business and Financial Weekly*, the research organization Trim Tabs estimates that individual investors have pulled nearly \$60 billion from stock-mutual funds so far this year while adding more than \$70 billion to money markets and small CDs. Individuals are fleeing equities after a nearly 20% drop (now closer to 15% off the highs) while heading to cash just in time for The Fed rate cuts to erode the yields on these accounts. On the opposite side, corporate insiders have been on a selling strike for nearly two months. Insider selling is down more than 90% from a year ago. Note that this is very bullish signal for the market.

Likely, Mr. Markets is looking for some answers in an uncertain world before he’s ready to forecast *better days ahead*. Today’s biggest uncertainties challenging the markets are: How much more will housing prices decline? How bad is the sub-prime mess? Will the banks be willing to lend again? Will consumers continue to spend? Will there be a recession in the US or are we just going through a period of slow growth? How high will oil go? Who will be our next President? Lastly, what will happen to tax rates?

No one can answer all these questions with surety, but we do know the following: Housing prices will eventually bottom. The sub-prime mess ultimately will be cleaned up. Banks will, once again, be eager to lend as they are hungry for profits. Consumers will continue to shop (we’re addicted). Oil will continue to be volatile. And come November 2008 we’ll have elected our next President.



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A few tougher questions to answer are: Will we have a recession, and what will happen to tax rates? Looking at the equity markets and bond yields we could conclude that a recession is likely already “priced” into the equity market and Treasury bond yields. Even if we experience a recession now, the downside risk in equity prices is likely limited and bond yields will likely stay low.

The probability is that the lowering of interest rates combined with falling home prices will soon put housing back on the path of “affordable” thereby stabilizing housing prices. According to the *LA Times*, the median home price in Southern California has fallen from a high of \$505,000 in February 2007 to \$415,000 as of January 2008. This represents an 18% drop thus far. Perhaps housing needs to fall another 10% from this level.

So is all this volatility ... friend or foe? Long-term investors should choose to view volatility and lower equity prices as an opportunity to acquire more shares at a discount. This is likely a good strategy if one believes that the long-term prospects of the country and economy will be positive. Historically, every bear market has been followed by a bull market and every bust economy is followed by a boom.

For the short-term investor it's a little more difficult. But it's always been! Imagine trying to call the “top” and “bottom” of the tech cycle, the real estate cycle, commodity prices and interest rates. Those who try may be able to get it right once or twice but studies show that, in the end, it's a fool's game.

Generally, staying diversified; having realistic expectations and trying to implement control over our emotions of fear and greed will likely serve us well. By the 4th quarter of 2008 many of today's uncertainties will essentially be determined. The combination of interest rate cuts, a stimulus package and time will begin to heal what ails the economy and Mr. Market will likely start predicting better days ahead. So what can we do in the mean time to help weather the current turbulence? If you are in the accumulation phase of life then **invest more**. If you are requiring income from your accounts then try to **minimize withdrawals and distributions** until Mr. Market' actions announce the arrival of better days. If we do have a recession it's likely to be shallow and fairly brief and the market may have already priced most of this in today's equity prices.

We know the current volatility can be unsettling and raise questions about your investment strategy. Such feelings and second guessing are very normal in uncertain times. So, please call your KWB Wealth Manager if you have any questions or concerns about your portfolio. In the meantime, rest assured that we will do all that we can do to help guide you through this period of increased volatility and turmoil.

We appreciate your continued confidence and wish you the very best in 2008.

Sincerely for the firm,

A handwritten signature in black ink, appearing to read 'Kerry'.

Kerrick W. Bubb
President, KWB Wealth Managers Group
LPL Registered Principal

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