

Market Commentary – September 15, 2008

By Doug Fehr, CFA, Director of Investment Research, Securities America

Dear Valued Client,

In a turn of events sure to make history, on Sunday, Sept. 14, 2008, Wall Street firm Lehman Brothers filed for bankruptcy protection, while Merrill Lynch agreed to sell itself to Bank of America for approximately \$50 billion. Meanwhile, American International Group has sought \$40 billion from the Federal Reserve, and other familiar companies are being placed on watch lists.

It may be difficult to find the silver lining in all of this. From a taxpayer's perspective, in one of the more reassuring acts, the government is now selectively helping only certain institutions. Despite taking control of the troubled mortgage finance companies Fannie Mae and Freddie Mac only a week earlier, the government would not bail out Lehman. We have to believe that the federal government and regulators have a far clearer view of the entire picture of the problems facing these financial institutions. This sends a clear message that it is up to Wall Street to solve its own problems.

That message is being heard loud and clear. Ten major banks agreed to create an emergency fund of \$70 billion that financial institutions can use to protect themselves in these tumultuous times.

This is not to say that this isn't a real tragedy. It is. Over 100,000 people have lost their jobs or will in the coming months. The largest repercussions may be felt in real estate in New York City and its surrounding communities and in luxury goods. It is safe to say, however, that investment banking will be back. It is an integral part of our free market economy and can be profitable for those willing to take the risks. But those playing the game in the future will be using a different set of rules and guidelines.

In one sense, we're enamored with Wall Street in the same way we are with Hollywood. Cousins, friends, nieces travel to the storied halls of international deal-making and return with riches, early retirement and even glamour. Yet the Financial sector today is only 15% of the S&P 500. Furthermore, outside of the top 10 U.S. financial companies in the S&P, there are 76 other companies with a market value totaling \$884 billion. While it's upsetting and costly to see the like of Lehman and Bear Stearns go away, there are many other mid-sized and regional companies who would love to grow into the voids they left behind. Simply, many opportunities exist today that didn't just last week.

Wall Street and its investment banks play an important role in the economy, as they function to transfer risk to those willing to take it in exchange for potential returns. In doing so, investment banks take on risks themselves, not with depositors' money. They use shareholder money, much of which comes from their own pockets. As we've seen so far in 2008, these investment banks were not diversified properly in how they allocated their capital and resources. If you're putting all your eggs in one basket, no matter how superior that basket is, once eggs break – you have no more eggs.

Largest U.S. Financial Corporations	Market Value (Bil)
Bank of America Corporation	\$142
J.P. Morgan Chase & Co.	\$133
Citigroup, Inc.	\$103
Wells Fargo Company	\$100
Goldman Sachs Group, Inc.	\$65
American International Group	\$58
US Bancorp	\$59
American Express Company	\$46
Morgan Stanley	\$45
Merrill Lynch & Company, Inc.	\$43
....76 others in S&P 500	\$884

(source: S&P 500, Morningstar, data as of 8-31-08)

This is the message we should remember as investors: diversify to reduce the risks you are willing to take. Stocks still remain one of the best ways to beat the effects of inflation over the long term. Naturally, you don't want to own the profits from just one source or company or industry or country, but from hundreds of companies. An allocation to bonds also can help reduce the volatility when stocks are down.

A lot of smart people have tried to call a bottom on Wall Street and the financial services industry this year. Although so far, they have all been wrong, this shouldn't keep long-term investors from cautiously allocating resources into under-priced securities once they are ready.

The issues found in the investment banking and related industries have clearly impacted the rest of the economy. We need stability in the financial markets to have a recovery in the housing industry and the overall economy. On the positive side, however, exports remain strong and economists generally predict that the United States will grow slowly or remain flat over the next few quarters. If oil prices continue to fall, easing pressure on consumers, our economy will also benefit.

In volatile markets we can find value in the words of a trusted advisor. Please use this as an opportunity to again discuss your tolerance for risk and plans for the future. With a properly diversified portfolio incorporating all aspects of our financial picture, we can better position ourselves for achieving our long term goals.

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Please note that the opinions expressed here are those of Doug Fehr, Director of Investment Research, Securities America Advisors, and should not be construed as investment advice and are subject to change with market conditions. All economic and performance information is historical and does not guarantee future results. Data come from the The Federal Reserve, Standard and Poors, WSJ.com, Morningstar.com and New York Times and are current as of September 15, 2008.