

March 30, 2004

Dear clients,

Greetings to all! Last week a client asked me to read an article about the stock market in which the author, a man named Paul Farrell, boldly stated "The next crash is coming ... it is coming!". Farrell's assertion/warning is that with the U.S. a seemingly obvious target for terrorist activity, the next strike will cause our stock market to crash, and therefore one should get out of stocks now and wait for the all clear sign before getting back into the market. As I was responding to this client I realized that most, if not all, of you might share similar concerns. So below is my perspective for all to read (with minimal editing to protect confidentiality):

*I read the "Next Crash" article and my take is that no reasonable person can dismiss the concerns that Farrell has. My own huge concern however is one of timing. It seems like Farrell is advocating bailing out of equities now, waiting for the terrorist "event" and presumed market crash, and then jumping back into equities. There is a saying about all stock market predictors that "they're never wrong they're just early." Who knows? Farrell sadly could be right on the money (perhaps poor choice of words) and this crash might happen soon and he will seem very prescient. But what if he is indeed "early" and the calamitous event doesn't happen for years, or ever? This piece will quietly drift into obscurity and he'll be writing about something else while those who heeded his advice will be left wondering when it is "safe" to go back in the water while they harvest miniscule fixed income returns.*

*Any way you look at it Farrell is urging his readers to use market timing to avoid his predicted stock market losses. If we bail out of equities now, we will be guaranteeing ourselves short-term annualized returns well under 4%. Obviously these returns will look spectacular if broad equity markets dip 25%, or more, but if they ascend, we will be in real trouble and in a perverse sort of way almost hoping for doom, gloom, and a crash.*

*My approach and response to any uncertain times (and when are they not?) is to make sure all clients in or near retirement have some meaningful percentage of their portfolios in bonds and money market vehicles, and not all in stocks. In addition to providing the short-term assurance that we won't be forced to sell stocks low to meet your liquidity needs, these investments should also provide us significant wherewithal to patiently ride out stock market pullbacks or crashes.*

*Although clearly from a rate of return standpoint we would be much better off being out of the stock market entirely if it crashes, and back in 100% when it's surging, this involves a level of prescience that no mere mortal will ever have. Countless studies show that just being out of the market for a few of its best days can have an enormously negative impact on long-term rates of return. I know you could say being out of the market on a few of its worst days could be great for returns, but this is market timing which is really much closer to gambling than it is to prudent long-term investing. Thousands will speculate as to when, what, and where, and the law of averages means some will get their prognostications right on, but determining who will be right and wrong in advance is the unknowable.*

*So much of investing boils down to evaluating risk. There is risk being in stocks and risk being out of stocks. A certain level of risk is quite healthy because without it there would be no difference in rates of return between keeping money in the bank or in the stock market and then our economy would truly be in long-term shambles. I join you and obviously hundreds of millions of people around the globe in being fearful of this world filled of terror and terrorists in which we now live. I just feel that the most prudent course of action is to maintain a very broadly diversified, well balanced, and cost-efficient portfolio through*

*thick and thin, watch our rate of portfolio consumption like a hawk, and as for the rest, hope and pray for the best. ...*

This was my response. I believe that just as important as it is for me to help clients construct and maintain appropriate and suitable portfolios, it is equally important I make sure all clients are comfortable with their investments. I know that I frequently hammer home the same points on the merits of diversification and taking a long-term perspective on the market, but I believe the repetition and reassurance is necessary to help you all feel more comfortable with your nest eggs and why we subject such valuable financial assets to such significant short-term volatility.

I know these are scary times. Please remember that I am always available for an office meeting or happy to email or talk on the phone if you ever have any questions about your investment programs or financial planning in general. I know we all wish the world was a safer place but reality seems to suggest otherwise. Nevertheless, please take considerable solace in knowing that regardless of the present state of geopolitical turmoil, you remain smartly and prudently invested for the long-term.

Very truly yours,

A handwritten signature consisting of the letters 'A' and 'F' in a cursive, stylized font.