

July 13, 2008

Dear clients,

It's a fact, there haven't been many places to hide lately from falling stock prices. The solid gains of April and May were pretty much all given back (and then some for certain markets) in June. What does this mean? And perhaps more importantly, what should we do? Not too much. I know "staying the course" is not a particularly popular expression nowadays but as pertains to your investments it is the right thing to do. You will probably see some activity in your accounts this next quarter as I rebalance but this will be routine. Pundits and prognosticators will continue to tell us all the reasons why we should flee the market to the safety of cash or treasuries but we no better. A recent headline in USA Today told us that 3 month treasuries have just outperformed the S&P 500 for the 10 year period ending June 30'th. Seeing this made me think of a great quote some clients and friends of mine recently shared with me from their local newspaper. It read, "*The stock market is a very efficient mechanism to take money from the impatient and give it to the patient.*"

I won't deny that it seems appealing to temporarily sit on the sidelines while stock markets are falling and economic news is dour. Wouldn't it be prudent to just take a breather and wait for the "all clear" signal before we again entrust our life savings to such fickle, volatile, and unpredictable market beasts? Superficially this appears the obvious and "safe" way to go but actually it is the opposite. You see stock markets are just as fickle, volatile, and unpredictable going up as they are going down. Remember 1995 through 1999 when the S&P 500 delivered returns exceeding 20% every year? After each of these years there was never a shortage of experts who warned us that this trend could not continue and that stocks would come crashing back down to earth the following year. Albeit there were many others who told us the opposite, and of course stocks finally did come crashing back down to earth from 2000 into 2003, but the point is that being patient and trusting the efficacy of a broadly diversified portfolio is an intelligent and rational way to maximize your long-term odds of success. This is truly investing your nest egg while most other strategies are glorified forms of speculating and/or gambling.

Sitting on the sidelines during bear markets and getting back in during bull markets is a tempting and seductive strategy but it necessitates having levels of prescience that just are not consistently achievable through skill. Can you imagine the devastation to your portfolio if after patiently riding out the bear market of 2000 through 2002 you finally just became so demoralized that you couldn't take it any longer and in 2003 decided to sit on the sidelines? You subsequently watched the market ascend through 2007 and then you couldn't take that any longer so you returned in 2008 just in time for the start of another rough patch. Or conversely, what havoc would have been wreaked to your portfolio if you heeded some experts' advice and took your profits after a 37% gain in 1995 "knowing" that the market was in for a "correction" soon and after four years of patiently waiting and watching others realize unprecedented gains you couldn't stand not participating any longer and jumped back in just at the start of the severe bear market of 2000 through 2002? This is exactly what so many did (see 4Q 2007 letter).

I try to keep things as simple as possible and in this case as alluring as they may seem successful market timing strategies mandate that you consistently be right not once but twice. You have to be right getting out **and** getting back in or vice versa. Markets can be counted on to periodically and sometimes severely put our patience to the test but if we can keep a clear and lucid focus on the behavior it takes to be savvy investors we will be that much ahead of those who can't.

Be well all,

