

## **Chapin Hill Advisors Market Comment 8-10-11**

### **The Wild Ride Continues!**

#### **Volatile Days in the markets!**

If you only tune in at the end of the day to get the market's finish, you may not realize what a wild ride it has been intra-day. Last week, we started the week off with a small loss of 10 points in the Dow. Tuesday was a big down day as the Dow fell 265 points, investors thought that was big news. They rallied a bit on Wednesday as the Dow was up just about 30 points and you may have thought it was a one-day sell-off.

But then Thursday arrived and the markets were down 300 points by midday and fluctuating back and forth in a very wide range. Concerns that both Italy and Spain would need assistance from the International Monetary Fund (IMF) and the European Union (EU) rocked the markets. Indications of slowing global growth continued to be posted. By the afternoon, selling accelerated and the Dow closed down 513 points!

Friday was another crazy day where we were down 170 and up 190 within minutes. We finished the day up 60. After the close of the US markets, S&P announced they were downgrading our debt which rocked the markets over the weekend. Asia opened down significantly, followed by Europe and then the U.S. The volatility was high and the Dow was down about 300 mid-afternoon only to fall into the close down 634 points!

On Tuesday, the market looked forward to an announcement from the Fed with many hoping for QE3 to rescue the markets. At 2:15pm, the Fed announced that they were maintaining a very low interest rate environment until 2013 and that the economy was weaker than they thought. The immediate reaction was a 205 point plunge in the Dow. Minutes later, the momentum started on the upside as the guru's on Wall Street dissected the notes and assumed that the Fed's stance would mean further intervention. The rally took the market from -205 to finish up 430 points – a 600 point swing!

We gave back those points and more as the Dow plummeted 519 points on Wednesday but we vacillated back and forth all day at some points, we were only down 200 points. Is a bottom forming? What will the next week bring?

#### **Giving up gains...**

The market's swift decline has turned the markets seriously negative year to date. Through August 10<sup>th</sup>, the Dow is -7.41%, the S&P -10.88% and the Nasdaq -10.22%, while small caps measured by the Russell 2000 is -16.8%.

From the highs in May 2011, it is even uglier as the Dow lost 16.7%, the S&P -18.22%, the Nasdaq -17.55% and the Russell 2000 -24%! The buy and hold crowd may tell you that this too shall pass and maintaining your positions will eventually pay off.

However, from the lows in July 2010 when the Fed announced the QE2 rescue and the markets were flooded with liquidity, the Dow rallied 34% to its May 2011 peak while S&P was up 35.6%, the Nasdaq up 40.1% and Russell 2000 up 47.8%. If you got in at the bottom and maintained your position, you have now erased a good portion of those gains as the July 2010 bottom to the recent lows of August 10, 2011 leaves you with a gain of 11.5% in the Dow, 10.9% in the S&P, 15.5% in the Nasdaq and 12.3% in the Russell.

Even more depressing is that the Dow has a meager 2.23% average annual return since 2000! The S&P has averaged 0.81% and the Nasdaq -2.2% while the Russell 2000 is still ahead with a 4.7% average for almost 11 years!

As I stopped in my favorite deli this morning, the manager (who trades recipes with me as we both love to cook) asked me what was going on in the markets. He then suggested that the average 35 year old had nothing to worry about as they had 30 years left to retire. My opinion is that a 35 year old has now given up the last 10 years of return due to the secular bear market. If we are correct and this bear continues (with rallies and declines) for another 5-10 years, that 35 year old is now 45 and no closer to any of their financial goals.

So in our opinion, buy and hold is out cold! You must adopt a different strategy and find a way to protect your principal and add non correlated assets. There are many ways to do this and a good advisor who is not running with the herd can help you.

### **France front and center....**

More news from Europe and none of it is good! Yesterday, the focus was on whether or not France would lose their AAA status. According to experts, the US only has a 5% risk of default while France is at 13%. The French banks got hit very hard on Wednesday as investors feared that their exposure to Irish and Greek debt was going to cause the banks serious problems. Some of the large banks were down almost 21% in a day! Source: Wallstreetrun.com (<http://wallstreetrun.com/wall-street-rattled-by-french-bank-worries-2.htm>)

After hours, France's President Nicolas Sarkozy called his finance and budget ministers back from holiday and gave them one week to come up with a plan to cut France's crippling debt burden. They pledged to reduce the budget deficit from last year's 7.1% to 3% by 2013. This means spending cuts are not likely to be taken well by the citizens.

The focus is still on Italy and concerns over how much exposure US banks have to debt of the PIIGS (Portugal, Italy, Ireland, Greece and Spain continues to weigh on the markets). The financial sector has gotten hit very hard leading the equity markets down. One famous hedge fund manager has lost billions due to his exposure to US banks. Meredith Whitney again made news calling for continued declines and consolidation of the US banking sector.

### **Will there be a rally?**

Many value investors are telling us that there are bargains galore and you should be picking them up. Many investors have been flocking to dividend paying stocks thinking they will lock in cash flow. There is a lot of cash on the sidelines and rallies in bear markets are often very powerful. The markets never go one direction forever. So at some point, there will be a rally. There is not yet enough fear in this market as measured by traditional sentiment indicators. Investors have witnessed three pullbacks of 7-15% over the last 2 years. They may assume that the next rally will wipe out the losses and all will be good.

We disagree and feel that any rally should be used to pare back your risk. You need to know what your risk tolerance and cash flow needs are for the next several years. Long term the emerging markets are growing and their needs are large which can drive returns in stocks. However, short term, our economy is in the doldrums and without a housing recovery and new jobs being added, we cannot recover. We believe that this long term secular bear market began in 2000. From October 2007 to March 2009, the S&P lost 56%. From the bottom in March 2009 to April 2011, the S&P gained 105%. Basically, back to even. If this decline continues even with

pockets of rallies, the gains of 2009-2011 will be erased and your goals will be a few years closer while your money has not been growing to help pay for those goals.

Prudence is advised and we are here to help. Please call us with questions and comments.

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