

Chapin Hill Advisors, Inc.
Market Comment 12-22-08

The Fed Uses All Available Tools!

Fed Action...

Last Tuesday, the Federal Reserve cut interest rates to a new low between zero and 0.25%! They also promised a whole host of consumer and corporate lending programs to stimulate the economy. They are throwing in every available arrow in their quivers to prove they are helping “Main Street” not just “Wall Street”.

They will just keep printing money in an attempt to stabilize the economy and stimulate both spending and lending.

The Fed is clearly willing to continue to print money to keep the economy alive, with worries about inflation taking a back seat to concerns about growth. No one can force the banks to lend but money is now very cheap. Mortgage rates finally responded and you can now lock in a 30 year at 5% or better – depending on your credit and size of the mortgage.

Market Action...

The market initially rallied on this news running up over 300 points only to give most of it back in the next few days as investors seemed to realize this was no quick fix and there is more pain to come.

The Dow finished down 51 for the week or -0.6% while the S&P rose 8 points or 0.9% - its third gain in the last four weeks. The S&P is now 18% above its' November 20th low but still down 43% from its' October 2007 highs.

Small stocks and technology benefited from increased expectations of growth as the Nasdaq rallied 24 points or 1.5% to 1564. The Nasdaq has rallied 13% in the last four weeks. The Russell 2000 jumped 18 points or 3.8% to 486. Which sectors will lead if the markets do rally? Will the leaders continue to be technology, basic materials and small cap stocks or will the big boys come out to play and load up on blue chips pushing the large cap laggards out in front?

Investors have been selling massive amounts of stocks. There was a net redemption of \$72 billion out of stocks in October alone. Generally, the individual investor is wrong and sells at or close to the bottom. This is by no means a guarantee but one more data point to review in deciding your short term strategy.

Searching for a Bottom

Many market pundits are predicting a Santa rally and we agree...only we are calling it an “Obama rally”. There is a lot of enthusiasm over the change in administration. People are disillusioned with the Republican administration. It is

appealing to have hope for a new team as the Democrats take over. Obama has been meeting with all the countries' Governors (a first) and making judicious choices for leadership as well as talking about an \$850 Billion additional stimulus plan! Big bucks after Paulson's \$700 Billion dollar stimulus.

Obama is planning on spending money on infrastructure and adding as many as 2.5 million jobs. We hear they are looking for "shovel ready" projects and you may consider "following the money". If Obama spends money on infrastructure – bridges, roads, tunnels, pipes, etc. – some sectors will benefit from this cash flow. Beneficiaries of this new cash flow could be companies in the engineering sector, heavy equipment manufacturers as well as material suppliers for the anticipating construction projects. We have already seen some of these stocks jump double digits in anticipation of this injection of new business.

Short term rally...

We do not believe that all is well or that the economy will heal quickly. We are anticipating a short term rally through the end of January. There is definitely some group rotation going on and the stocks that led the last rallies may not be the clear leaders in this one. Basic materials have already bounced and real estate, after being pounded, seems to be responding. Small cap stocks may indeed take the lead but you cannot discount the money on the sidelines waiting to go into blue chip stocks.

We still believe we are in a secular bear market and will have sharp bear and bull rallies. September through November certainly brought out the bear and decimated a lot of portfolios. The old "buy and hold" adage is getting a little tired as brokers try to keep their clients in the market.

We are meeting with many new clients as they despair over losses in their portfolios at other firms. Some are quite panicked at losing 30-40% of their liquid net-worth and are looking for direction and guidance. We are hearing war stories of 70+ year old entertaining returning to work as they lost much of their nest eggs.

Unfortunately, if you have a loss of 30-50% in your portfolio, even a sharp rally of 25-35% will only minimize those losses - not eliminate them. If a \$10 stock falls to \$8, it lost 20% but must grow 25% to get even. The recoup return rate gets bigger as the losses add up. A \$10 stock that loses 50% and is now \$5 must now double to break even. So if you lost 50% and we get a 35% rally, you are actually still down over 30% from where you started. Very distressing if you are relying on that nest egg to fund your current income or other cash flow needs.

We would suggest you review your present holdings and create a game plan to use any rally to adjust your present portfolio. Know what your goals are and anticipate a "worst case scenario" going forward. Most folks don't want to face the "what if's", but you need to be pragmatic. You may indeed lose your job, your pension benefits may get cut, your bonus may not be there for several years,

inflation may continue to add up on your food and energy bills, etc. Focus on what your goals and objectives are and what you should or could do if the market falls sharply again later in 2009. Past secular bear markets have taken back gains in the cyclical bulls very rapidly. So if history repeats itself, we could be looking at a roller coaster in 2009. (although past performance is no guarantee of future results.)

Oil Drops and Goldman posts losses

Oil continued its slide as the December contract traded down to the low \$30's on Friday. Prices have fallen over 80% since their July highs while demand has fallen about one third. OPEC is trying to reign in supply and many producers have shut down or slowed down production as the price of oil plummeted. We do believe there will be some type of rally in oil over the next month as prices adjust to meet demand.

Goldman Sachs posted the first loss since going public ten years ago. They reported a loss of \$2.12 billion or \$4.97 a share. The stock rallied as many felt all the bad news was now out. Morgan Stanley also posted a loss of \$2.37 billion or \$2.34 a share. Both firms are in the midst of converting to commercial banking institutions. This conversion changes their fiscal year from November 30th to December 31st. This one month "stub year" may very well allow them to use this period to write down assets. This lets them start with a better balance sheet, fewer write-offs in fiscal 2009 and may limit some of the write-off's going forward.

Inflation, gold and Treasuries

Pumping all this money into the economy on a global basis is inflationary. No one is worried about inflation right now as the administrations of so many countries are concerned with keeping their economies going. Gold may bounce over the next few months as the dollar loses its luster. If we have inflation and concern over the stability of the US market and the dollar, gold is likely to be considered the safe asset and a flight to "quality" may take place, driving the price of the metal up.

Investors have been throwing money into Treasuries, even with negative real yields. This cannot continue. We feel that Treasuries are the next "bubble" and you will see the prices drop and yields rise no matter what Bernanke and company attempt to do at the Fed.

Review and Adjust

These are difficult times and it is not easy to make decisions about your portfolio. We may still see last minute tax selling come in but there is a ton of cash on the sidelines. So if the market rally starts to look "real" to investors, we could see the flood of liquidity push up the markets quickly.

Use any rally we get to review your present portfolio. Do not focus simply on performance but ask questions about risk, you diversification between asset

classes, how safe your “safe” holdings are and what your expected future potential return in the current asset. Protecting your principal during times like this is critical.

Do not be shy about re-allocating your 401(k) portfolio as well. There is no tax incurred by switching investments and generally no fee on changes in the portfolio. You should seek professional advice to assist you in making asset allocation decisions. If you can, you should take advantage of market rallies with a more traditional allocation. Then on market peaks, switch to a more conservative allocation to attempt to protect your portfolio. You will need to check the rules on your particular 401(k) plan to see if they limit trades and what fees you may incur.

Please call us or email us with questions or concerns, we are happy to help.

All the best for a safe and healthy Holiday Season

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