Chapin Hill Advisors, Inc. Market Comment 10-25-07

The Wild Ride Continues!

Last week was a tough week for the markets. Four out of five days were down for most and all 5 down for the Dow. The grand finale was a 367 drop for the Dow Jones Industrial Average – on the 20th anniversary of the 1987 crash. The drop was mild relative to 1987's Black Monday 23% decline, however the pullback and the number of stocks declining versus the number increasing was of concern.

The Dow's drop translated into a 2.6% decline for the day and 4% for the week. The S&P fell 3.9% for the week and wiped out the entire prior month's gain. Nasdaq fared better, falling just under 3% for the week. Big techs like Google and Yahoo supported the Nasdaq. Small caps fared the worst giving up almost 6% and wiping out most of the year's returns.

Oil hit a new high of almost $90 a barrel stirring new concerns about inflation. The dollar was weak and gold was strong. Concerns about the economy led the day as Catepillar and 3M warned of slowing future sales. Several retailers reported earnings and the future is not looking very rosy. Consumer spending seems to be weakening. Remember, consumer spending comprises almost 70% of our GDP (gross domestic product).

This week opened mixed but the markets have provided a wild ride with big intraday swings. The Dow opened on Monday down over 100 points, but turned around midday -- up 140 but finishing the day only plus 20 points. On Tuesday, the Dow flipped back and forth but finished up just under 1%.

Wednesday was another wild day as Merrill Lynch shocked the market by releasing their earnings with an $8 billion dollar write-off on bad loans. Just two weeks ago, they estimated this charge-off at $5 billion. Oops – a 60% increase! The news spooked the markets and the Dow dropped almost 200 points and the Nasdaq followed with even steeper losses – down 2.7% at the worst point.

Mid-afternoon, Wall Street, in their inimitable style, decided once again that this "bad news" was "good news" as the Fed would be forced to lower rates! Predictions for a rate cut next week rose to 100% from 91% on Monday and 31% a week ago. The markets whipped around on bets of the Fed rescuing the market. The indices trimmed their losses with the Dow finishing down 1 point and the Nasdaq down 0.8%.

At this point, the August lows seem to be holding up. The indices are bouncing off those lows but if they were to break those critical support levels we would likely see more significant downside. Some bears are calling for a 15% decline in US indices and 30% for emerging markets.

Concerns continue to be on the forefront Thursday as Washington Mutual's stock plunged 6%, leading the other financials into further declines. Bank of America reported poor earnings so they fired the head of investment banking and announced that 3,000 jobs would be cut.

The raging fires in California continue and the losses are estimated at over $500 million. Over 1500 homes have been destroyed. The insurance stocks came under pressure as the damage continues to add up. AIG suffered the most as continued concerns about their exposure to sub-prime debt mounted.

Durable goods fell another 1.7% and the four month average of jobless claims increased. Existing home sales plummeted dropping 8% in September – the biggest drop since 1999. New home sales fell 23% and now the talk is of no recovery until 2009-2011. Not good news for the retiree who planned to sell their home to fund their upcoming retirement!

It takes nerves of steel if you are watching the market on a regular basis. There continues to be a bias on Wall Street that all is well, Goldilocks is still alive and global growth will save us.

A rate cut will only go so far in bailing out the markets and the consumer. Foreclosures continue to mount and bankruptcies are increasing. New York City reported a 70% increase in year over year bankruptcy claims. The trend is of concern.

Congress is attempting to get a tax overhaul approved to provide some relief to Alternative Minimum Tax (AMT) which is continuing to capture more and more Americans, driving up their tax bills. It's a huge undertaking and is likely to be a battlefield as the revenue must be made up elsewhere and the total is in the billions.

If you own individual stocks, be sure you know why you own them and be vigilant. If you have a diversified portfolio, be sure you are not over-weighted in some areas without realizing it. Many money managers own similar sectors and you may have a concentration in financial services or energy that you are not aware you have. Look to offset some of the risk in your portfolio in some method, preferably with professional help. Do not be too quick to rush into beaten up stocks or sectors as there may be further downside.

As always, feel free to call us with questions or comments.