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The New Reality

as of Friday November 7th, 2008 (Dow closed at 8,696 on Thursday)

The primary stock market indexes (DJIA & S&P500) are down 38-42% from their high point one year ago and a good portion of that loss came during the past month. Some non-US stock funds have lost slightly more than the US indexes. During the past month corporate bonds encountered the worst market losses we remember ever experiencing. Gold prices which normally provide a safe place during troubled times have also dropped. And everyone seems to have a discouraging story to tell about real estate. The one good result was that energy prices have tumbled but energy related stocks also dropped significantly.

For investors and portfolio managers alike, other than going to cash, there has been no place to hide from the market's turmoil. All segments of the market remain extremely volatile. We believe a very significant recession is upon us as we hear about unemployment rising and individuals and businesses cutting back on expenditures for personal enjoyment or business improvement. Basically, the economic news is not good as we contemplate the looming recession and how it personally affects us.

The New Reality is stock and real estate market values are down significantly from where they were a year ago; the recession is global; there are expectations and unknowns associated with the election of president-elect Barack Obama and the change that will be introduced; there is a heightened awareness of the risk associated with too much or the wrong kind of debt; there will potentially be a higher tax burden; etc. You could probably add your personal New Reality.

As a result, our review of financial reports and articles has increased substantially in our attempt to understand what is going on with the markets and how we should advise clients. The following is taken from an article read this morning: "Today there are thoughtful, experienced, respected economists, bankers, investors and businessmen who can give you well-reasoned, logical, documented arguments why this bear market is different; why this time the economic problems are different; why this time things are going to get worse – and hence, why this is not a good time to invest in common stocks, even though they may appear low. People are saying, 'There are so many bewildering uncertainties, and so many enormous problems still facing us – both long and short term – that there is no hope for more than an occasional rally until some of these uncertainties are cleared up. This is a whole new ball game.'"

The above might seem like it was written today, but what caught my attention was that the above was written by the chairman of a major mutual fund group on November 7th, 1974, 34 years ago today, during the 1973-1974 oil embargo related bear market where the S&P 500 dropped approximately 45%. The article went on to say, "Each economic, market and financial crisis is different from previous ones. But in their very difference, there is commonality. Each crisis is characterized by its own new set of nonrecurring factors, its own set of apparently insoluble problems, and its own set of apparently logical reasons for well-founded pessimism about the future."

Ultimately the realization will come that despite all the bad news, despite the gloomy outlook, the United States will survive, and that strongly financed, well-managed corporations (stocks) are going to survive. In the real world, companies create wealth, and the stock market is a proxy for that reality. As a firm, we want the fund managers we recommend to take seriously the analysis they perform on the companies they choose to invest our money into. Based upon our meetings with analysts and teleconference meetings with fund managers, we are convinced this parameter is being adhered to.

We live in the New Reality of reduced portfolio values and do not expect a quick return to last year's market values. Some say it could be several years. But in working with this New Reality and as a hypothetical example, should the DJIA increase to just 9,600 (DJIA peak was 13,896 on September 28, 2007), the rate of return from current values to 9,600 could be 10+%. Compared to alternative investments, while not guaranteed, that would be an excellent rate of return.

While we realize daily commerce and spending is important to the economic well-being of our country, thrift is also encouraged. This doesn't mean the total avoidance of spending, but as T.N. Carver, a depression era economist stated, "thrift consists of spending money wisely ... in the long run, the thrifty man will spend more, because he will have more to spend than the thriftless man; and the thrifty community will be a community in which more money is spent than in the thriftless community."

Are we at or near the stock market bottom? My wife and I were on a recent road trip when the answer to this elusive question struck me. We were in need of filling our gas tank at a time when gas prices were significantly higher than what they currently are. At the time we saw a station selling gas for \$3.03 and thought we found a bargain so we filled up as it was the lowest price we had seen. But to our surprise, further down the road gas sold for \$2.98; then \$2.89 (5% lower); then back up to \$3.29. There was absolutely no way of knowing where the lowest price would be.

Initially I was bugged by missing the lowest price, but we did purchase relatively low, which was good. No-one knows where the stock market bottom is, or if there are more downs coming our way, but based upon our reading from several stock managers we trust, we believe stocks are relatively low. Recently Warren Buffett was quoted in the New York Times as saying, "I emphasize that I have no idea what the market will do in the short term. Today, my money and my mouth (in reference to putting your money where your mouth is) both say buy equities." Several other well-known bargain hunters (including Marty Whitman & Jeremy Grantham) have made statements that they haven't seen such reasonable stock values in over 20 years.

All of this leads us to the conclusion, **if it is a good time to buy, we do not believe it can also be a good time to sell.** One difficulty we all experience is our emotions conflicting with our logic. Consider us as your partners. Our objective is to provide you with peace of mind during these troubling and potentially fearful times. Is there an issue that is unresolved in your mind that you believe we could assist with? If so, please do not hesitate to contact us.

Tax Loss Exchanges – Within the next month, we will be providing many non-IRA investors with tax loss exchange recommendations so there will be capital losses to offset other income and capital gains produced by the mutual funds.

I would like to repeat what we concluded last month, we are resilient and ultimately I believe we will have a better governmental/financial structure in place going forward once we get through the current disaster. ***Thank you for your trust during this difficult financial time!***

Prepared November 7th, 2008 by: Thomas A. Morrison, CPA, CFP®, Principal