

## YOLLES-SAMRAH WEALTH MANAGEMENT, LLC

July 22, 2008

Dear Valued Client:

Bear markets, negative reports in the media and difficult economic times naturally provoke concerns and we have had a number of productive conversations with clients in recent weeks about current conditions. We thought that it would be helpful to share a number of insights from these conversations because we know that many clients have similar concerns. While all of the clients whom we've recently spoken with understand the merit of our long-term disciplined approach including not trying to "time" the market's inevitable ups and downs; they did want to review the status of their portfolios in light of the current economic environment.

Please note that after a number of key second quarter and June economic measures are released in late July, we will provide our standard analysis.

We've touched on three main themes during recent conversations with clients:

1. Although bear markets and recessions occur periodically, they are nonetheless always unnerving. Understanding the nature of bear markets can help.
2. Market timing (temporarily going to cash) does not work and most often leads investors to miss the inevitable recovery that occurs after a bear market. Successful investors know to **stick with their game plan** during difficult conditions and that bull markets often begin when economic readings are bleak.
3. Markets and economies are resilient and a disciplined long-term approach is the best way to participate and earn long-term capital market returns.

Please note that your second quarter performance report is enclosed. Most balanced portfolios experienced a total return around -1% to -2% for the second quarter versus -3.2% for the S&P 500 and -6% to -8% for the first 6 months versus -12.8% for the S&P. More aggressive portfolios experienced greater losses, but generally slightly better returns than the S&P.

### **BEAR MARKETS OCCUR AND ARE FOLLOWED BY BULL MARKETS**

Table 1 (see Appendix #1) illustrates the duration of the 11 bear markets since World War II (one every 5.7 years). The average bear market is short and severe lasting only a little over 1-year (443 days) and resulting in a -31.5% decline. The current bear market is 286 days old (to 7/21) and experienced a -22.4% decline before rallying in mid July. Bear market's steepest declines have occurred after a mania/bubble when valuations become extended as was the case with tech stocks in 1999 and "nifty-fifty growth stocks" in 1972. The recent real estate and credit boom did not create a stock market mania and therefore equity valuations are not extreme and corporate balance sheets are solid. The exception is the financial sector which is down sharply with many bank stocks down over 50% since the market peaked in late October of 2007.

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While we recognize that every bear market environment is unique, the factors mentioned above point to a bear market which is likely closer to its end than beginning. Additionally, bearish investor sentiment is at its highest level since 2002, which ironically is often a bullish indicator since pessimistic investors hold cash and short-positions which can act as pent up demand for stocks.

The average post WWII bull market lasted 4.6 years, gained 160% and recovered the ground lost in the prior bear market within 2 years (with two longer exceptions). Empirical evidence shows that stocks have been the best long-term inflation hedge: providing a “real” return of 7% above the rate of inflation.

Since World War II, the stock market has experienced strong advances after recessions. Data from Ibbotson Associates shows that 6 months after a recession, the S&P 500 has advanced on average 11.4% and the Russell 2000 (small stock) index has advanced 20.1%. Three years after a recession, the S&P has returned, on average, 47.7% (13.9% per year) and the Russell 2000 has gained 74.0% (20.3% per year).

Markets will often experience gains during recessions. Table 2 (see Appendix #1) illustrates that the S&P 500 has gained an average of 3.9% during the 9 recessions since 1950 and that the average recession (contraction) has lasted only 10.3 months. The post WWII data shows that on average the stock market will start falling 7 months before a recession begins **and start rising 6 months before the average recession ends.**

### A DISCIPLINED STRATEGY IS PREFERRED

Too often investors will emotionally want to sell after a market decline (when they're feeling bad and seeing negative media headlines) and buy after a market advance (when they're feeling good). Researchers find that investors misperceive their own investment timing prowess; i.e., investors will only remember times that they had an instinct to sell when the market actually went down while selectively forgetting the prior occasions when they had an instinct to sell but the market rose.

One reason academic studies find that market timing does not work is that the market experiences most of its annual gains over a small number of days and missing just a few of these “good” days eliminates most of the annual return. Analyzing each trading day for the S&P 500 between 1990 and 2007 we found the following:

- The stock market is open approximately 255 days each year.
- The market appreciated 7.55% per year with dividend income adding an additional 2.5% per year.
- Investors who missed the **3 best days** each year would have lost -1.06% per year.

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In a typical year, the S&P 500 trades within a range with random gains offsetting losses; then over a small number of days the market will achieve its entire gain for the year. The market will average about 2.5% on each of these 3 “best” days resulting in the 7.5% average annual price return for stocks. It is statistically very unlikely that one can get out of the stock market then back in to not miss any of the 3 best days. A better approach is a long-term broadly diversified commitment to the global stock market for an appropriate part of one’s portfolio. While we also read bearish media opinions on a daily basis, we remain committed to the value of our disciplined approach and its ability to provide consistent returns.

### **GLOBAL MARKETS ARE RESILIENT**

Table 3 (see Appendix #2) summarizes stock price returns as well as financial and geopolitical crises for three separate two-decade periods since 1950. The first period (1951-70) saw the S&P 500 advance from 24 to 92: a cumulative 287.7% gain (7.39% per year). The second period (1971 – 90) similarly saw a cumulative 258.4% return (6.95% per year) and the most recent period experienced a cumulative 287.6% (8.30% per year) gain. The consistency of these results is not a coincidence; stocks have averaged approximately 10.5% per year since 1926: about 3% of this total return has come from dividends and the remaining 7.5% has come from stock price appreciation which is in line with 7%+ annual growth in corporate earnings. The market has consistently made progress over time despite numerous wars, slowdowns and financial crises: it’s reasonable to expect that this pattern will continue and that the current real estate, energy and credit crises will be dealt with.

We appreciate your continued confidence and are happy to speak with you at any time.

Sincerely,

Ron Yolles, JD, CFA

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## APPENDIX #1

Table 1: Post WWII Bear Markets					
AVERAGES			-31.5%	288	443
Start Bear	Date of 20% Decline	End Bear	% Loss	Days to 20% Decline	Duration of Bear
05/29/46	09/03/46	05/19/47	-28.5%	97	355
06/15/48	06/13/49	06/13/49	-20.6%	363	363
08/02/56	10/21/57	10/22/57	-21.6%	445	446
12/12/61	05/28/62	06/26/62	-28.0%	167	196
02/09/66	08/29/66	10/07/66	-22.2%	201	240
11/29/68	01/29/70	05/26/70	-36.1%	426	543
01/11/73	11/27/73	10/03/74	-48.2%	320	630
11/28/80	02/22/82	08/12/82	-27.1%	451	622
08/25/87	10/19/87	12/04/87	-33.5%	55	101
03/24/00	03/12/01	10/09/02	-49.1%	353	929
10/09/07	07/07/08			272	
Source: Barron's 7/7/08; Bespoke Inv. Group					

Table 2: Recessions and Stock Market Returns		
AVERAGE:	3.9%	10.3
Recession Duration	S&P 500 Return	Contraction (months)
July '53 to May '54	23.6%	10
August '57 to April '58	-1.3%	8
April '60 to February '61	20.0%	10
December '69 to November '70	-1.9%	11
November '73 to March '75	-7.8%	16
January '80 to July '80	9.5%	6
July '81 to November '82	-14.2%	16
July '90 to March '91	7.9%	8
March '01 to November '01	-0.9%	8
Source: Vanguard, Wikipedia		

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## APPENDIX #2

<b>Table 3: The Long-Term Resiliency of Markets</b>				
<b>2 Decade Period*</b>	<b>S&amp;P 500 Level</b>	<b>Price Return</b>	<b>Compound Annual Return (price only)</b>	<b>Significant Crises During Period</b>
<b>(1951 - 1970)</b>				Cold, Korean and Vietnam Wars, Bay of Pigs, Cuban Missile, Kennedy assassination, Mid-East (6-day) War, Robert Kennedy, Martin Luther King, Penn Central Bankruptcy and Recessions 1953-54 and 1957-58
1951	24			
1970	92	<b>287.7%</b>	<b>7.39%</b>	
<b>(1971 - 1990)</b>				Stagflation, Nifty-Fifty stock "bubble", Mid-East (Yom Kippur) War, Oil Embargo, Nixon, New York City near bankruptcy, Chrysler bailout, Iran hostage crisis, Soviet-Afghan War, Inflation 15%/ Prime Rate 20%, Washington Power Bond Default, Junk Bond (Drexel) Scandal, Orange County California default and Recessions 1973-75 and 1980-82
1971	92			
1990	330	<b>258.4%</b>	<b>6.95%</b>	
<b>(1991 - 6/30/08)</b>				Persian Gulf, Iraq and Afghan Wars, Mexican, Russian and Long Term Capital Currency Crises and bailouts, "Dot.Com" stock bubble, September 11, 2001, Real Estate Bubble and Credit Crisis, Bear Stearns, Fannie Mae and Freddie Mac [near] defaults, \$147 oil and Recessions 1990-91, 2001-03 and (?)
1991	330			
2008	1280	<b>287.6%</b>	<b>8.30%</b>	

\* Source: Standard and Poor's; periods are 19, 19 and 17.5 years respectively