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Bear Tracks Sighted!

Monthly Update from Your Portfolio Management Team—March 7, 2008

After mounting a slight recovery in early February, the market gave way at the end of the month and finished with its 4th negative month in a row. At this point the Dow and S&P are both down almost 10% for the year. From the peak in early October, these indices are down close to 15%. This decline marks the worst decline in stocks since 2002, and many observers are wondering if conditions will continue to slide into "bear market" territory. There are many definitions of a bear market. We like to use the relatively simple definition of a 20% decline from a market peak to define a bear market. Our best guess is that before this turbulence is complete, we will slide into bear market territory.

In our opinion there are too many headwinds for the market to overcome to believe the market will not dip lower in the coming months. The biggest challenge is that we have an economy slowing dangerously close to recession (which means negative growth), coupled with growing evidence of rising inflation pressures (just witness the high gasoline prices, soaring commodity prices and steadily creeping inflation numbers). The Fed feels confident it can handle one or the other, but not both, since what works to cure recession (lowering interest rates) is the opposite of what is needed to ease inflation (raising interest rates).

What does all this turmoil mean for FSA clients? Well, as you know, we are mostly in money markets at this time, so the turmoil in 2008 has had only a minor impact on our accounts—overall FSA accounts are down less than 2% (through the end of February). We are keeping our powder dry, while waiting for an opportunity to get reinvested once the storm clouds have passed.

The money market we are using for most accounts is the Treasury money market because we wanted the safest money market that Schwab offered. With all the concerns about the derivative securities floating out there, we wanted to make sure our money market investments were iron-clad secure. Of course, we are giving up over a percent in yield if we hold this position for the entire year, but given the uncertainties out there, it is a sacrifice we are willing to make. We plan to switch back to the higher yielding Premier money market once the credit issue calms down—hopefully in the second half of this year.

If you have any questions about your specific accounts, please do not hesitate to call or email us.