

INDEX	1917	ONE YEAR LATER	5 YEARS LATER	1920	ONE YEAR LATER	5 YEARS LATER	1929	ONE YEAR LATER	5 YEARS LATER	1930	ONE YEAR LATER	5 YEARS LATER
DJIA	-21.71%	10.51%	31.98%	-32.90%	12.30%	117.73%	-17.17%	-33.77%	-58.10%	-33.77%	-52.67%	-12.43%
S&P 500	N/A	N/A	N/A	-24.53%	7.40%	51.96%	-11.91%	-28.48%	-55.71%	-28.48%	-47.07%	-12.45%
NASDAQ COMP	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
RUSSELL 2000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

INDEX	1931	ONE YEAR LATER	5 YEARS LATER	1937	ONE YEAR LATER	5 YEARS LATER	1973	ONE YEAR LATER	5 YEARS LATER	1974	ONE YEAR LATER	5 YEARS LATER
DJIA	-52.67%	-22.64%	130.94%	-32.82%	27.73%	-1.20%	-16.58%	-27.57%	-5.39%	-27.57%	38.32%	36.11%
S&P 500	-47.07%	-15.15%	111.58%	-38.59%	25.21%	-7.39%	-17.40%	-29.72%	-1.48%	-29.72%	31.55%	57.38%
NASDAQ COMP	N/A	N/A	N/A	N/A	N/A	N/A	-31.06%	-35.11%	27.97%	-35.11%	29.76%	152.66%
RUSSELL 2000	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

INDEX	2000	ONE YEAR LATER	5 YEARS LATER	2001	ONE YEAR LATER	5 YEARS LATER	2002	ONE YEAR LATER	5 YEARS LATER	2008
DJIA	-6.18%	-7.10%	-0.64%	-7.10%	-16.76%	24.36%	-16.76%	25.32%	59.02%	-33.84%
S&P 500	-10.14%	-13.04%	-5.45%	-13.04%	-23.37%	23.54%	-23.37%	26.38%	66.89%	-38.49%
NASDAQ COMP	-39.29%	-21.05%	-10.73%	-21.05%	-31.53%	23.84%	-31.53%	50.01%	98.60%	-40.54%
RUSSELL 2000	-4.20%	1.03%	39.23%	1.03%	-21.58%	61.24%	-21.58%	45.37%	99.96%	-34.80%

The period of 1973 and 1974 represents one of the worst recessions in the history of our country, and the stock market fared pretty badly during this two-year period. However, the five year performance of the major indices following 1974 was very positive, particularly for the NASDAQ, which returned 153 percent. The more recent period of 2000 through 2002 (the bursting of the tech bubble) was also tough, but resulted in strong five-year performance from 2002 through 2007, a period of time which witnessed new, all-time highs for stocks and 100 percent returns for the NASDAQ and Russell 2000.

For the Dow, of the thirteen years where we had at least one of the major indices down at least 20 percent, eight of those thirteen years the Dow was up the following year, and by an average of 14.27 percent. For nine of those thirteen years, the Dow was up over the following five years, and by an average of 69 percent.

For the S&P 500, which was established in 1918, there were nine years in which at least one of the major indices was down at least twenty percent, and in those nine years, the S&P 500 was up the following year in four instances, and by an average of 22.64 percent. Looking at the five year period following the down year, the S&P 500 was up in five of those nine years, and by an average of 62.27 percent.

While this data is hardly conclusive proof that we will rebound big in 2009, in the three years where the Dow or S&P 500 were down at least thirty percent, as we had in 2008, and excluding the primary years of the Great Depression during which stocks performed poorly (1929-1931), stocks rebounded sharply the next year all three times.



This year's performance was the third worst for the Dow and S&P 500 since they were established, and the worst since 1931 for the Dow and 1937 for the S&P 500. It was the worst performance for the NASDAQ since its inception in 1971, (even worse than 2000), the year in which the tech bubble burst. It was also the worst year for the Russell 2000 since its inception in 1987.

What I feel this data shows is that, for long-term investors, years of significant negative performance for stocks are typically followed by strong outperformance, especially given a five year time horizon. So the question on everyone's mind is: Are we going into another Great Depression, or is this just a normal bear market and economic recession? No one can know for sure, the answer to this important question, and I don't pretend to have all the answers. However, there are some striking and important differences I can point to, which lead me to believe that we are not entering a multi-year, severe depression. Most significantly is the multi-tiered response of the government, which was completely absent in the early stages of the Great Depression. President Hoover believed that the free market should be left alone to work-out the problems of the day, and refused to act in any way to stem the tide of massive bank failures, the stock market collapse, and massive unemployment. By the time FDR took office, and despite the New Deal, the damage had been done, and most importantly, the confidence of the citizenry had been shattered. It really took World War II to pull us completely out of the Great Depression.

The economy of the United States is much like the Titanic, not in the sense that it is sinking to the bottom of the Atlantic with all of us aboard, but in that it is like a large ship with a small rudder—it takes a long time for the economy to react, once the wheel of fiscal and monetary policy has been turned. Luckily, our current government, while making several huge and devastating mistakes—allowing Lehman to fail; delaying the passage of the bailout; delaying the bailout of the automakers; not spending the bailout money for its intended purpose of buying distressed securities—has done enough of the right things—injecting massive amounts of liquidity to the global financial system, saving AIG, facilitating several key buyouts (Merrill, Bear, etc.); lowering rates to zero percent; using the TARP to bailout the autos—that I believe the economy has what it needs to prevent a major depression. The additional massive stimulus that Obama will sign shortly, which will likely exceed a trillion dollars, should add strength to this argument.

In my recent research piece entitled, *[‘The Case for the Greatest Bull Market in History’](#)*, which is available free of charge on my website at www.mpam.bz, I detail my arguments supporting my belief that stocks, among all available asset classes, represent the best opportunity for outperformance over the coming few years. The combination of valuations for stocks compared with all other asset classes, the enormous amount of cash sitting on the sidelines—about 70 percent of the total value of the S&P 500—and the complete lack of growth potential in any other asset class over the foreseeable future, among other reasons, have led me to this conclusion.

FIXED INCOME

The performance of fixed income securities has been mixed this year, with treasuries outperforming every other asset class, but corporate bonds and tax-frees performing poorly. The combination of frozen credit markets, making it impossible for corporations to issue debt this past summer, coupled with the near bankruptcy of the municipal bond insurers, had a

devastating impact on the prices of these securities. Spreads for corporates, even those of high-quality companies, and for tax-frees, are at historical highs, providing opportunities for the astute fixed income investor. One must understand the risks and do their homework, but opportunities do exist for substantial yields and capital gains in the investment grade corporate and tax-free markets. I am still recommending that my clients keep maturities at five years and shorter, as rates in general are at historic lows, and I believe that they will rise over the coming few years, potentially erasing capital gains provided by the current spreads offered today.

REAL ESTATE

Home prices have fallen by an average of approximately twenty percent nationwide, and by almost forty percent locally. I expect a further decline of approximately ten to fifteen percent, both locally and nationally, but feel we are past the worst of the negative impact of the excesses that led us to our current economic troubles. Inventories are still extremely high, and prices will continue to fall as long as they remain high. I estimate that it will take at least another year before inventories and prices fall enough to form a bottom in the real estate market. Even so, I do not expect prices to rebound quickly, and would not expect to see prices return to the recent highs we have seen for many years, and not ever in some markets. The bottom line here is, for those who want to buy a home as opposed to speculate on a house, the next few years will offer opportunities. As an investment vehicle, however, I do not expect real estate to offer attractive returns for the foreseeable future.

COMMODITIES

I have never considered commodities to be an investment vehicle, although there are some managed futures funds that have achieved outstanding results. Given the weakness in the economy, and the sizable drops we have seen in commodities prices, especially in energy, I believe there will be potential for profits in commodities as the economy starts to recover in mid-2009. I prefer to focus on the companies that sell commodities rather than directly investing in commodities contracts. The energy sector has been pummeled, and energy stocks look attractive. I believe gold is significantly overvalued and will likely fall as investors once again seek-out risk and exit the flight to safety trade.

Keep in mind that stocks anticipate recoveries in the economy, normally by at least six months. If I am correct, and the economy begins to recover in the second quarter, stocks should begin to rally very shortly (if they haven't already). I believe we will look back at the fourth quarter of 2008 as one of the worst markets in history, and also as one of the greatest opportunities to buy quality stocks at screaming bargains.

I would like to invite you to hear a more detailed presentation of my expectations for 2009 at my upcoming seminar on February 5th. For more information, please call me at (805) 898-1400. If you would prefer a personal, one-on-one meeting and a comprehensive portfolio review, free of charge, please call me or email me at craig@mpam.bz.

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