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*“Few things in
the world are
more powerful
than a
positive push...”*

Investing in Tough Times

The stock markets have been selling off very heavily over the last several weeks and I know from experience that this sort of sell off and all the heavy media attention it attracts tends to make investors anxious and worried. So, I wanted to touch base with everyone to assess what's happening, what we're doing about it, and why I believe it will all come out okay.

First let me note that this sell off is something I have been expecting for over six months. It's been a bit surprising how much bullish momentum there was driving stock prices up in the face of all the well known problems in the real estate and mortgage markets which spread to big losses for the major banks and brokerage firms.

But asset prices have always tended to move in cycles with strong euphoric advances usually followed by a downward correction as prices pull back in line with reality. Even real estate, which so many people long believed only moved up in price, has been pulling back in a broad correction over the last year or so. Stock prices behave in exactly the same way, only faster.

As I repeatedly mentioned in my newsletters, I have felt we needed to proceed with caution over the past year or so. This meant that I have tended to maintain a reasonably conservative balance in money market funds in the accounts I manage. This cash acts much like the ballast in a ship, which helps it maintain stability when the seas get rough, as they are today in the stock markets.

I have also maintained my clear buy and sell disciplines which are designed to protect you on the downside by selling losers quickly while losses are relatively small and letting our winners run. One of the clear lessons I've learned over the years in this business is that a few really large capital gains overcome many small capital losses in producing successful portfolios. The only way to get a few really large capital gains is to avoid taking small profits on the way up.

One important lesson I learned through the very rough bear markets from 2000 through 2002, was that a handful of stocks actually did extremely well, even in those worst of times. Three of these bear market winners were Coach, Inc., ITT, and Bed, Bath, and Beyond, all of which more than doubled in price during that period. If I could have known this in advance, I would have bought only these companies, but of course no one could know this in advance. In the end, it was the buy and sell discipline that helped my clients profit from their performance.

This brings me to the question of why don't we just sell everything and sit in cash until the storm blows over. If I or anyone else could accurately predict the bottom and the next upturn, this might be a good idea. In practice, however, this strategy provides a sense of relief in the short term, but usually turns out to be a very bad idea in the long term. Once someone has moved entirely to cash, it becomes extremely hard to pull the trigger again and get back into the market. Since no one rings a bell at the bottom, it's very unlikely that your nerves recover until well after the markets have rebounded and left you behind.

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*... A smile.
A word of
optimism
and hope. A
"you can do it"
when things
are tough. "*

Richard M. DeVos

As a case that illustrates this point, one of my very fine clients back in 2002, when I was working for UBS/ PaineWebber, experienced a sharp drop in value in a balanced stock portfolio near the bottom of the bear market. This client became so frightened by this that they insisted on selling it all and going entirely into cash. At the time, I had been working with this client only a very short time and thus, I did not yet have enough rapport with him to talk him down off of that ledge. So, I had to let him jump. After a few months of drifting sideways, the portfolio he sold, which I was using with several other clients, began to rise in value quite dramatically. By the time the selling client was willing to reenter the stock market, the original portfolio had not only recovered the entire amount he had lost, but had gone on to double in value from there. Being on the sidelines in cash had cost him ultimately over 10 times as much as the amount of his initial loss.

So what is our strategy? We will continue to focus on a disciplined buy and sell strategy. Since buying into a market falling on heavy volume is very risky, we will be increasing our cash allocations as our sell discipline leads us to sell some stocks along the way. In addition, there are some new exchange traded funds available, which allow investors to profit from falling markets. On a cautious basis, I have been adding these to certain portfolios where the risk and reward profile makes this a sensible choice. Moreover, all bear markets will have rallies along the way and we will look to take advantage of these as they present themselves.

When the market indicators show a sustainable upturn is underway, we should then be able to gradually redeploy our cash to build value on the way back up.

There are some things you can do to help as we work our way through this challenging time. Try to minimize your exposure to the hysteria in the media as much as you can. They are in the business of selling advertising so they are going to sensationalize the bad news that's out there. This can really wear you down. If you do get anxious and are losing sleep, please give me a call and let's talk through your personal situation. I'm sure we can find a way to help set your mind at ease.

Finally, try to remember that these corrections are a normal part of the market process and they always end and the sun always shines after the storm. If we hold hands and communicate well, we will all get through this just fine.

Warm Regards

Jette