Monday, September 22, 2008

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MARKET REVIEW:

What's next?
Before I get to the answer, let's take a quick look at where we have been. Last week has to go down as one of the most memorable in Wall Street history. On Monday, the Dow Jones Industrial Average fell 504 points. On Wednesday, it dropped 417 points. On Thursday, the Dow swung more than 600 points inter-session to close up 400-plus; and then it tacked on another 370 on Friday.

It was volatile, but not as disconcerting as October 1987. I was at my desk that day as well. Note that China's stock market is down more than 60% this year. That's a brutal bear.

At the close on Wednesday, the S&P 500 was down 26% from its all-time high, which is the average peak-to-trough move in a bear market. Intraday on Thursday, the S&P fell to 1134 before rebounding. Average bear markets over the last 75 years was 32%, so we may have so to go yet, but I believe that the Fed and Treasury are finally acting to forestall a crash.

Outside the market environment, the U.S. economy appeared to continue growing, as it has since the recession of 2000- 2001. Indeed, the 2Q GDP growth rate was recently revised upward to 3.3%. The economy may not technically be in a recession, but it sure feels like one. Especially in the auto, media-newspaper, housing and paper industries.

In addition to Wall Street's woes, unemployment is rising, housing prices are continuing to decline especially in Nevada, California and Florida, and global economic growth seems to be stalling.

The U.S. government took control. In fact, looking ahead, the clearest answer to the "What's next" question is that investors can expect regulators to have a much greater influence in the markets and the economy in the years to come. It has gone from underregulation toward overregulation, but it will go through re-writing the regulations as well. Ultimately, the US taxpayers are the one's who would have paid in a much more severe fashion and the regulation would have been more draconian, if the system had been left to fail.

The government will address Detroit and the automakers after this. The newspapers are also in a difficult spot. These programs from the government – low-cost loans, debt assumption or outright ownership — will be designed to reduce overall risk for the economy and the markets. With reduced risk, investors should expect reduced long-term returns.

Last week's volatility made the clear point that the market was unable to resolve the root cause of its problems, credit and credit derivatives.

Institutions were either unable to raise it or unwilling to lend it. Financial institutions simply did not have confidence that they would get back the money they lent out — even overnight — to major organizations.

At least the United States Treasury is in a strong position to raise the hundreds of billions it will need for the massive bank bailout plan. On Friday, yields on T-bills were a minuscule 0.05%, though the yields have risen to 0.61% over the weekend.

Looking ahead, investors should understand the new landscape as they address their portfolios. The credit market turmoil will have a negative impact on the economy. On a narrow basis, jobs in the financial services sector will be lost and the unemployment rate will continue to climb. More broadly, companies will not have access to affordable capital and will have a harder time expanding.

The environment will continue to feel like a recession, even if GDP doesn’t turn all the way negative. Stagflation is a real probability.

With Wall Street essentially shut down for repairs, new sources of capital will be tapped. These sources will include private equity funds, sovereign wealth funds, major corporations such as General Electric, Berkshire Hathaway and Google; and foreign nations, particularly from the Mideast and Asia.

The SEC’s decision to forbid short-selling on financial services stocks is a short-term positive for the sector and the market, but raises longer-term risks for investors. The beauty of the U.S. stock markets is they open for business and process trades for investors who want to buy and sell.

The lack of information related to financial services stocks made investing in the sector extremely difficult last week. The SEC’s decision to curb short-selling is not too far from Russia’s decision to outright shut down its markets because of heavy selling. When buyers and sellers ultimately decide that they can’t trade on a market, they will move to another market.

Hedge funds will continue to be portrayed as the “bad guys.” Every market crash needs a bad guy. In the 1980s, program trading was the problem. In 2000-2002, the securities analysts misled investors. Now we have the short-selling hedge funds behind the demise of some of Wall Street’s most prestigious names.

Industries that already have experience with regulation, such as Utilities, may prove to be safe havens, as the government’s grip on the economy tightens.

Companies that fund their operations with cash flow and have strong balance sheets will not be exposed to the volatile and expensive credit markets.

Sound management teams are more important than ever. In a typical economic environment, our analysts tend to focus on growth and value. Given the challenges of today’s landscape, quality management is proving to be the best port in the storm.