



MALLARD ALERT

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Irrational Terror

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I began this Market Alert on Thursday morning, with the Dow having closed at about 10,600, the same level it stood at nine years ago, and 25% below its high from last October. This morning (Friday) the Dow is up hundreds of points, after having risen over 400 points yesterday. What a difference thirty-six hours makes!

These are tumultuous times. It seems that every week or two the government reluctantly agrees to bail out a major financial institution, promising to spend tens of billions of dollars in this, the last step necessary to stop the financial crisis that began a little over a year ago. The last step, that is, until next week. The bail-outs are justified as necessary to avert a complete market meltdown. Is it any surprise that investors have panicked this year?

And investors have panicked. On Wednesday investors bought ninety-day Treasury notes that yielded 0.07%. Putnam decided to close (end operations) a money market fund to prevent an unmanageable run on it. Foreign stock markets have fallen even more than US markets, down 33% from their highs of a year ago. US and foreign stocks were not grossly overpriced a year ago, and yet they have fallen 25 to 33%..

The level of raw fear is astounding. Last week a financial planner posed a question on a professional website asking how to help a retired client prepare for an 80% decline in stock values. To twist the words of Alan Greenspan, these are signs of irrational terror. (For the record, Greenspan recently joined 'the sky is falling' crowd.)

I encountered the last straw on Wednesday, when I felt **myself** being sucked into this 'the end is near' mania. I have been an unabashed optimist for Mallard's twelve years. Problems in Russia and the collapse of Long Term Capital? I call that a buying opportunity. September 1998 and the Asian Flu—another buying opportunity. 9/11? Leave your stocks alone—the world will keep revolving, the economy will recover and with it, stocks. So when I began to wonder whether this could be 'the big one', the second Great Depression, there are only two likely outcomes: a major meltdown is imminent, or irrational terror is infecting investors (and trying to pull me down with it), and we are darn close to the lowest point of the current painful market decline. I have come to believe that the second is the more likely outcome.

I won't bore you with the justifications for the doomsday scenario. Suffice it to say that money is the lifeblood of the economy, financial institutions (Bear Stearns, Fannie Mae, Merrill Lynch, AIG) are the veins and arteries, and the patient has been rushed to intensive care due to severe circulatory distress.

The patient (the US and global economy) is being treated by trained professionals, heroic measures are being taken, and the patient is a very hardy individual. Think of Evel Knievel—were there any bones that he had not broken? Yet, he recovered, time and again, a testament to his doctors, and to his resilience, his constitution.

The doctors know what they are doing. The Fed began to reduce rates over a year ago. This was the right

Market Crisis—Will the Patient Survive?

move at the right time. Amazingly, Congress passed a stimulus bill in record time, well targeted to those who needed it most, and those who would (of necessity) spend it quickly and thus help the economy. There is no gridlock in DC—Congress is ready to do what is necessary to heal the US economy. When the Fed bailed out Fannie Mae and Freddie Mac, they fired the executives and the board—they announced loudly that incompetence will no longer be rewarded.

Heroic steps are being taken. The past major government actions have been very well considered, and have been warranted, to prevent a drastically worsening condition. In the past twenty-four hours, there are plans to buy the bad loans ('blood clots') that have kept banks from serving their role of letting money flow through the economy. They have also stepped up to assure investors that their money markets are safe.

The US economy is very rugged. We have withstood two world wars, a Cold War, several major military actions, an oil embargo and inflation spiral, a stock market collapse, an S&L crisis, and a major terrorist attack. Like a phoenix, in each case, the US economy rose again.

At What Price?

Is the cure worse than the disease? Are the government's actions worsening the crisis? How can promising billions of (and perhaps a trillion) dollars, money that our deficit-addicted government lacks, solve anything? Quite simply, there is no other course.

Herbert Hoover, at the start of the Great Depression, chose to do little, and tried to let the patient heal naturally. This proved to be a dismal failure. FDR's administration tried everything, spending money it lacked, and did everything conceivable to resuscitate the US economy. They knew that borrowed money can be repaid, but only by an economy that has recovered.

It will not be a smooth recovery. There is still significant rehabilitation necessary. The road to recovery, however, begins with diagnosing the problem and all of the symptoms, and selecting steps

to begin fixing them.

What should you do if you are nervous?

If at all possible, follow these three steps. First, determine how uncomfortable you are (I can just stand it, it is unbearable, or no problems at all), and **write it down**. Second, do nothing. I mean nothing. Change nothing in your portfolio and make no changes to new contributions. Third, when stocks recover (say with the Dow reaches 13,500 or so), then review what you wrote down. If you were nervous today, then at that time reduce your level of stocks, so that, at the next sharp downturn, you will avoid that level of stress.

In the meantime, try to maintain your portfolio's allocation, remember that the housing markets and the stock markets are likely close to their low points, and your patience should be rewarded. If you are able, cut back on your spending a bit, to reduce withdrawals at this time from your portfolio (or to increase your contributions to your portfolio).

Let me finish with some random, positive notes:

Oil, which all of the experts were predicting earlier this year would bring the US economy to its knees, has fallen about 33% since mid-July.

US recessions typically last three quarters—the longest in forty years lasted five. We are finishing our fifth quarter of troubled times this month.

Five year treasuries yield about 2.8%, the same yield as the average yield of the four largest US companies (Exxon, Walmart, GE, and Microsoft). If these four companies enjoy **any** growth in the next five years, they will provide better returns.

Investors on Wednesday were willing to receive only **0.07% yield** for three-month T-notes. Is that the sign of a rational investor?

Many investors have been experiencing irrational terror. Fight that temptation. We can recover together.

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