

October 6, 2008

Dear Friends,

We are experiencing the final phase of fear for this cycle. It is an inevitable happening at the bottom of a cycle. Today's stock market volume may not have been high enough to call it a "capitulation." Very high volume is associated with the big final "sell-off." Further, since the markets recovered from the lowest levels of the session, it may take another day or two of deep fear to get what is needed. Also, the European and Asian markets will be reacting overnight to our markets. This means there is a good chance that tomorrow can be equally intense if not more so.

According to reports, the institutional, private equity and hedge funds are selling wholesale. This will be followed by individuals, who believe this will never stop.

### **That is when it stops.**

This has been a credit market crisis that has increasingly become a stock market crisis and may or may not become a prolonged economic crisis. If confidence returns soon, the worst economic conditions may not come about. As the credit markets begin to function again, which I expect to happen, we are going to once again see very low interest rates for a while, lower energy costs and other short term deflationary forces.

### **Please remember several things:**

**First, market declines are always temporary.** As I write, some of the greatest, best managed companies in America and the world are selling at prices that may never be seen again in our lifetimes.

**Second, the intense desire for increased standards of living around the world will not stop.** This alone will inspire ongoing economic growth for a very long time. Once this crisis period passes, the reality and magnitude of this will reappear. Right now it's hidden in the emotions of the moment.

**Third, by many measures, the amount of liquidity in the world is enormous! Lending is frozen, but cash is everywhere.** Some reports show cash reserves in all forms are somewhere between 6 and 10 Trillion

dollars! Once confidence returns to the credit and stock markets, this money will NOT stay in US Treasuries or other short term vehicles. These "safe havens" are paying fractions of a percent. 3 Month T-bills today are paying less than half percent (0.4940%)! Adjusted for inflation and taxes, when you own these YOU are PAYING the government, they aren't paying you. This won't last very long once confidence returns. Trillions of dollars will flow out of these places and back into more traditional investment vehicles, both bonds and stocks.

Try not to react to these events today or the next day or so. I understand that reason does not overcome fear. I have tried to prepare us all to withstand the overwhelming of reason by fear. When people are frightened, facts don't count, unless you are prepared. We are now there. The fear must play itself out and usually does with great intensity. It is possible that we will see this very soon.

As you all have experienced, if you had the courage to open your statements, September has been one of, if not the, worst months in market history. As statements arrive, those with less understanding may react and give up. This is a great time of opportunity, but by the time many realize it, the markets will have regained a great deal. I am not talking days, but months into mid-late next year. However, it isn't out of the question to see very intense "up" days in the stock market. So much money is available, that we shouldn't be surprised to see huge moves up, sometime in the next weeks.

The stock market will anticipate the economic recovery and relative normalization of the credit markets. Some significant financial companies will not survive. Several have disappeared already. However, thousands of companies have severely depressed share values and perhaps slowing business. These companies thrive when the cycle turns and the US and global economies once again reflect the striving of billions of people seeking a better life.

The financial markets will never be the same after this experience. While increased regulation is good and inevitable, we have to be sure not to substitute one problem for another. The unregulated credit market "derivatives" need to be very carefully supervised, with rules to prevent the development of another huge "shadow" credit market, completely divorced from the real economy; a real economy in which you and I live and on

which we rely. But let's be honest about it. The "smartest" folks on Wall St. created this problem. The "smartest" folks in Washington, D.C., aren't any more skilled at creating an environment that won't go too far and stifle or smother the capital formation. Open markets and private enterprise are needed for the creative and innovative ideas which are essential in building the future.

There has been a trend since the 1950's to model the social sciences after the image and methodologies of the "hard" sciences, like physics. It hasn't been working very well with the money arena. The "smartest" on Wall St., given unlimited computer power, lots of arcane mathematics and, in many cases, unimaginable pools of leveraged private capital, have brought us to the most dangerous financial precipice since the mistakes of the Depression days during the early 1930's.

Investment has been discarded for speculation and the relationship between lender and borrower has been weakened and stretched to anonymity. Massive trading and elaborate programmed speculation has replaced the concept of share ownership. A shareholder should be and act as an owner, not as a renter by the hour.

The most profound purpose of debt is or should be to produce equity. We should borrow to build value. Now this important tool has lost its way. The modern purpose of debt seems to be the creation of more debt, not equity. Debt, producing more debt, undermines the entire global capital market. It massively benefits a relative few and transfers the risk to third parties, particularly to the government.....to YOU and me.

We have allowed a massive inverted pyramid of debt to rest on a relatively small equity base. When the base becomes shaky or weakened, the inverted pyramid trembles and is at risk of collapse. This is what the Federal Reserve, US Treasury, Congress and international central banks are attempting to counter. They also helped create the problem. The citizens of the world are the losers if the capital markets fail to function. All the wonderful progress of billions of people to live beyond subsistence and of the citizens of the developed world to achieve financial security has been jeopardized.

As painful and destructive as this has been, it is, fortunately, almost at its conclusion. Only after this storm has receded, will we be able to fully

assess the damage and take the most productive reconstructive steps. Investors who brave this phase will, in my opinion, regain value in their investments and, perhaps, be highly rewarded from these very low share values. Those who were frightened out of the markets will risk being left to small gains, which after taxes and inflation, will significantly affect their ability to maintain their standards of living, particularly in retirement.

This is the most significant message: this down market is not unique. It will end (soon I expect) and human enterprise will resurrect our optimism, confidence and hope for the future. It has always been this way and it will be so this time as well.

As ever, with my expectations for your Good Wealth,  
Jerry!