

ARISTA

INVESTMENT ADVISORS, LTD

Registered Investment Advisor

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Financial Bulimia:

A saw-tooth, traders' and speculators' market...for now

This is an unsettled, unsettling and frustrating time in economic and market cycles. We have become accustomed to the compression of experience, induced by data and information overload, saturation coverage of events and a restlessness characterized by a "been there, done that" attitude. Nevertheless, some dynamics have their own rhythms. Our desire for economies and markets to quickly move through a difficult time is being frustrated by the current realities.

I have had many conversations with you and fellow planners and investment advisors during the past months. All of us are appropriately concerned about the adversity we are currently experiencing. No one experiences market and personal investment values declining without real concerns, anxiety and second guessing.

The fearful still see "Exit" or "Beware, there be dragons!" signs; students of history see "Entrance" or "The greatest companies in America are on sale at 5 and 10 year discounts!" signs. The news will continue to seem increasingly gloomy, but the markets will begin to build higher over the next few quarters. The least correlated realities seem to be economic "news," expressed as human feelings, and the long term directional trends of market indexes. It is also important to beware the political rhetoric from Congress, righteously exhorting (I almost said "extorting"!) us to fear the terrible times in which we live.

So, get ready for the storm of bad news, down numbers, end of the world financial rhetoric--and for the markets to go back down a bit, as the post election emotional letdown creates a void that, given our need for pain, will only be satisfied with doom, doom and more doom. And just as the doom saturates everything, the markets will begin to move up, more than down, and build on the future--just as most people are finally convinced that nothing will ever improve. However, improve it will, and faster than expected, leaving the incredulous to wish they had another chance to invest at the bargain prices they once feared.

I also understand the frustration of being invested, with no cash available to add to your investments during this very low period. I am basically in that situation myself, as I am always fully invested. However, even small amounts invested during the next six months will add to the recovery of value over the next few years.

Hey, Yogi!

Bad news is bad news, until it becomes good news. If Yogi Berra didn't say this, he could have. Three cases in point: interest rate cuts, oil prices and inflation (CPI). When central banks cut rates, the first reaction is, "Economies must be bad and/or getting worse." When oil prices drop, the first reaction is, "The economy must still be slowing and so there is less demand for oil," when CPI drops 1.00%, the first reaction is "Deflation is on the way." Then, at some magic moment, sometimes arriving very quickly, the sentiment changes to, "Wow! Low interest rates! Wow! Low oil/energy/commodity prices! Wow! Lower Inflation! What great stimulants for increased economic activity!" Assuming that we don't experience a complete stall-out of "consumer"

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spending, as has happened in Japan since the 1990s, these and other “facts” will very probably morph into positives well ahead of “sentiment.” What the news headlines don’t reveal is that how we feel about things is a lagging indicator. This means we react to what has already happened and especially to HOW what has happened is communicated to us. When the “facts” change, it takes quite a while for the feelings to reflect it. How many of us feel as good about the reduction in energy (heating, gasoline, etc.) prices as we felt negatively about the increasing prices just a few months ago?

This is one of the most significant reasons that many, if not most, investors will not reenter the markets or invest additional capital until the markets have already gone up, sometimes way up. The “comfort zone” is a lagging indicator. For most, the news and the markets have to already be positive before the feelings follow. Decisions contrary to the moment, are among the hardest disciplines to exercise and even more difficult to master.

I have suggested in several newsletters that during this period is the time to either enter the U.S. equity markets or add to quality positions you already own. I still believe this to be true.

Myth of Authority

As I have mentioned in the many meetings over the past month or so, the massive Federal Reserve, Congressional infusions of capital, parallel actions of governments and central banks around the world, including a large Chinese governmental “stimulus,” was a desperate application of haphazard life support measures, designed for one thing only: to keep the “patient” alive long enough for someone to figure out what was actually happening, what to do to restore sufficient confidence and allow for a period of stability and healing. The “patient” cannot simply be restored to the previous condition. We have to become convinced of significant “lifestyle” changes to foster good health.

This is the period we are in now. The “patient” is on life support and will survive. When we are under extreme stress, time slows way down. The bankruptcy announcement by Lehmann Brothers, which began the intense market declines/volatility we have been experiencing, was on September 15th—65 days ago. It has been about two months since the institutional investors panicked, went psychotic, and took the markets—and our emotions—with them. To many, these months have felt like a lifetime. We live in an era of intense compression. Events come at a dizzying pace and feelings follow. This same compression can, and I believe will, lead to the recovery in the economy and markets more quickly than expected by many. As we approach the end of the year the economic news will worsen, but markets will already begin the next phase. After the Presidential inauguration, a blizzard of activity will begin, which during the “honeymoon period,” will lift spirits and the markets. It won’t be the end of all the anxiety, but it will begin a new cycle of hope and justified positive expectation.

All the clichés of life (“It’s always darkest before the dawn” “Every cloud has a silver lining” “Spring follows winter”) persist because they represent profound truths of human experience. The markets have now bounced off the low, set last month, four times. This is a good sign. It helps to remember that often the first third to a half of bull markets happens in the first intense move up. With all the cash (\$10-12 Trillion) in money funds, short term bonds, CDs and Treasuries there is an ocean of liquidity waiting to do something more productive than wait. Today (11-20-08) 30 day T-bills were again yielding 0.031%. That is, thirty one, one hundredths of one percent, annual rate, which is a several percent negative yield after inflation and taxes. Maybe the psychosis hasn’t ended yet...but it will. Get ready.

As always, here’s to YOUR Good Wealth!

Jerry!

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