



## Third Quarter 2008 Investment Report

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### They Shoot Horses Don't They?

Despite the fact that global Capitalism is more prevalent today than ever before, it does have its drawbacks. For starters, it doesn't have empathy. It doesn't feel sorry for those negatively affected by it. You're in a recession? **Tough!** Your company's gone bankrupt? **Big deal!** Can't feed your kids? **Not its problem!** Capitalism is similar to the law of the jungle -- survival of the fittest. When supply and demand line up against each other, Capitalism really doesn't care who wins. The weak become dust, and the strong continue onward until a future time when they may also hit the ground. With Capitalism, it's all in a day's work, and there are no emotional repercussions regardless of the outcome.

With humans, it's a different story. We simply aren't fond of economic hardships, or losing our jobs, or not providing for our families. Consequently, we empower our government to attempt to tweak Capitalism so that we can thrive from its benefits, but buffer ourselves from its adversities. That's the reason for the Securities Acts of 1933 and 1934, ongoing actions by the Federal Reserve and US Treasury, and the myriad layers of state and federal laws and regulations promulgated over the last 75 years.

The recent federal \$700 Billion bailout is an example of our government doing its darnedest to prevent as much human misery as possible. Some extreme pundits have labeled it "The End of Capitalism," because of the great lengths the government has taken to prevent those jungle losers from becoming dust. Those questioning the government's actions do not feel taxpayers should be propping up inferior companies nor helping greedy executives stay employed. After all, they reason, they shoot horses when they can no longer function -- should it be any different when a company can no longer survive on its own?

In our view, there is a big difference. The government bailout of financial institutions and its guarantee of money market funds were not simply to save poorly run companies and their execs. Rather, it was an attempt to prevent a firestorm of spiraling economic upheaval that would negatively affect all in its path, with the potential to hurt the little guys on Main Street even harder than the bigwigs on Wall Street.

It took mistakes by all parties to get this real estate/sub prime mortgage/credit crunch-debacle to its current status. Yes, financing companies were greedy by extending mortgages to unsound owners. And Wall Street banks and brokers tried to leverage the resulting multi-layered/collateralized debt to the hilt. But doesn't the lack of government oversight also point to errors from that side of the equation? And lastly, those homeowners and speculative landlords initially requesting the risky mortgages didn't have guns at their heads. They apparently believed that real estate prices would increase forever and/or interest rates would stay historically low as well. In effect, all parties share in

the blame.

Perhaps the ugliest part of the federal bailout was the grotesque political partisanship underbelly that was so blatantly exposed during the process. Certain Congressional members outwardly admitting that the reason they didn't vote for the failed first bill was because their feathers were ruffled by a speech by the House Majority Leader. How's that for putting their constituency first? Even worse was the blatant pandering and pork barrel spending used in the second (passed) bill for the sole purpose of luring the votes needed. It clearly was a low point in our legislature's history, and an example of what is seriously wrong with our current political culture.

## Patience Is a Virtue

During bear markets, we consistently advise clients to be patient and disciplined, and wait out the downturns. This is not easy to do, and we also know that sometimes you may get a bit tired of hearing this advice. The chart below is the reason behind it. It shows what happens to stocks (the S&P 500) after hitting market lows during an economic downturn.

S&P 500 Low Date	S&P 500 Gain (Loss) After			
	3 Months	6 Months	9 Months	12 Months
June 13, 1949	14.5%	19.2%	26.6%	33.7%
September 14, 1953	9.9%	17.7%	27.5%	38.5%
October 22, 1957	6.1%	9.8%	19.0%	31.5%
October 25, 1960	15.9%	25.2%	27.6%	30.9%
May 26, 1970	16.9%	20.8%	38.7%	44.5%
October 3, 1974	13.5%	29.9%	51.5%	34.6%
March 27, 1980	18.3%	31.1%	39.1%	37.1%
August 12, 1982	37.8%	41.6%	61.1%	57.7%
October 11, 1990	6.7%	28.8%	28.7%	28.8%
October 9, 2002	19.4%	11.5%	29.0%	33.7%
<b>Average</b>	<b>15.9%</b>	<b>23.6%</b>	<b>34.8%</b>	<b>37.1%</b>

Source: Ned Davis Research, Inc. / Standard & Poor's

As you can see, after a weak economy, the markets consistently improved, and quickly. More importantly, nobody signals when it starts, and often it occurs with the worst of the economic news still to come. This is the reason we often repeat that you must be in the market on the last day of the bear market in order to get the full benefit of the first day (and week, month, quarter and year) of the new bull market.

## Third Quarter 2008 Asset Class Returns

	3rd Qtr	'08 YTD
<b>S &amp; P 500</b>	-8.36%	-19.32%
<b>Large Cap Value</b>	-8.24%	-17.94%
<b>Medium Cap</b>	-15.06%	-21.77%
<b>Small Cap</b>	-5.02%	-12.83%
<b>Small Cap Value</b>	-1.02%	-11.34%
<b>Micro Cap</b>	0.05%	-13.34%
<b>Real Estate</b>	5.35%	1.80%
<b>Intermediate Income</b>	-2.67%	-1.78%
<b>Long Term Income</b>	-3.60%	-3.89%
<b>Int'l Large Cap</b>	-18.97%	-26.23%
<b>Int'l Large Cap Value</b>	-17.79%	-28.98%
<b>Int'l Small Cap</b>	-22.43%	-28.57%
<b>Int'l Small Cap Value</b>	-20.83%	-27.65%
<b>Int'l Emerging Mkts</b>	-25.98%	-34.63%
<b>Int'l Em. Mkts Value</b>	-25.83%	-35.57%

<b><i>Int'l Em. Mkts Small</i></b>	-24.22%	-39.06%
<b><i>Pacific</i></b>	-17.89%	-23.51%
<b><i>European</i></b>	-19.43%	-29.34%
<b><i>Int'l Real Estate</i></b>	-13.32%	-28.21%

Vanguard Group and DFA, Inc.

The third quarter was the worst performing quarter since the early 2000's. Up until mid-September, several domestic asset classes had positive returns. But after Lehman's demise, Merrill Lynch's takeover by Bank of America and AIG being "rescued" by the Feds, the financial industry quickly began to unravel. In addition, a large money market fund announced that its value was less than \$1.00 per share. Within hours, the US Treasury and Federal Reserve developed a plan to use at least \$700 Billion to buy back the "toxic" mortgages on the books of numerous banks and investment houses, as well as guarantee money market funds that had stable value as of September 19th. After much political posturing, this bailout plan was passed on October 3rd, and as of this writing, foreign markets are going through their own bloodletting, which in turn is flowing over into US markets.

Interestingly, there were some positive asset class returns for the quarter. Both Real Estate and Micro Cap stocks were in the black for the quarter. Without question, all international asset classes' percentages were down from mid-teen to mid-twenties. Much of that underperformance was due to a strengthening dollar, which weighed heavily on foreign stocks denominated in non-US dollar currencies. Lastly, with the exception of US Treasury bonds, intermediate and long term fixed income also lost value for the quarter.

When will we hit a bottom? Clearly, the current volatility shows that the bottom could occur at any time. However, most bottoms are recognized only in retrospect, after several months have passed and dramatic market gains have already occurred.

Remember the following:

- When there is major panic selling in the market, it is typically in the last stages of its correction.
- There is more than \$4 Trillion in domestic money market funds and several times that in US Treasury Bills, much of which is earmarked for stocks when this correction is done. These funds will act as fuel to propel the stock market for years once the bear market is over.
- Stock valuations are cheaper today than at any time in the last few decades. Rational minds buy, not sell, when prices are cheap.
- Large Cap domestic stocks, exemplified by the S&P 500, have had a below average 10 year performance period. Historically these periods have been followed by times of dramatic out-performance.
- The time when the market is at its cheapest is the time for the best prospective market performance; it is also the time of most fear in the market cycle.

As always, your Quarterly Performance Report accompanies this letter. If we have managed your portfolio for less than three months, you will receive a partial report, and a complete one will follow next quarter.

We will continue to keep you up to date with the use of email updates. If you have not yet received these updates but would like to, please contact your advisor. Also, please feel free to call us whenever you have a particular question or concern.

Sincerely,

**Dixon Hughes Wealth Advisors**