

2009 Investment Commentary

October 2009

The third quarter has ended in what continues to be one of the most eventful years for the stock market and the economy.

It has been nearly a year since the weekend that shook the foundations of Wall Street and of the global financial system. Lehman Brothers collapsed, Merrill Lynch vanished as an independent entity and AIG was taken over by the U.S. government.

In light of that, we believe it is important to briefly summarize where we've been this year, where we are today and the prospects for the period ahead.

Where we've been

Six months ago, in early March, it truly did feel like the world might be coming to an end. The media dominated the airwaves with talk of a return to a Great Depression-like economy. Understandably, fear was rampant and stocks responded to these nightmarish scenarios by hitting the lowest levels in years.

Since the market lows in March, the economy has moved back from the precipice. There is a growing consensus that the economy will return to growth in the second half of this year. The publication, "The Economist", recently ran a cover story discussing the extent to which the economic recovery is being led by Asia.

As a result, we've had a strong recovery in global markets. From their bottom in March, stock markets are up over 50%, retracing a good portion of their losses.

Where we are today

Two years ago, the market was characterized by rampant optimism. The U.S. market had hit a new high in November of 2007 and any concerns were set aside as minor annoyances.

By contrast, six months ago the market was overwhelmed by absolute pessimism – there was no sign of hope anywhere.

Today, the market is somewhere between those two extremes and many investors can be characterized as extremely nervous.

Five Lessons from the Last Twelve Months

1. *We are reminded just how volatile stocks are.*
2. *The importance of true diversification became clear.*
3. *Many investors discovered that they're less comfortable with risk and volatility in their portfolio than they had believed.*
4. *Investors were also reminded of the need to focus on what they can control – understanding their cash needs and thinking through how much risk they can tolerate to fund those needs.*
5. *In some cases, investors began rethinking retirement plans as a result.*

As a general rule, a certain level of healthy anxiety is positive – what gets investors in trouble is an excess of either optimism or pessimism. While today’s mood may be a bit too pessimistic, being cautious in the current market makes sense ... provided that prudent caution doesn’t cross the line into panicked inertia or hasty decisions.

The good news is that there are still excellent opportunities for investors who are prepared for short term volatility. We spend a lot of time listening to the best market minds and to managers who have lived through multiple cycles. We are reassured that most say that they are still finding very good value – not to the extent that they did earlier this year, but still well ahead of what they would have seen a year ago.

The outlook going forward

In August, “Business Week” ran a cover story called “The Case for Optimism.” The premise was simple: Beyond the issues facing the global economy, there are many underlying positives that give cause for optimism if we look out two or three years or beyond.

Powerful forces under the surface will drive economic growth ... and that economic growth will drive stock prices. Examples include the positive impact of technology, the recovering US housing market, the revitalization of economies and the incredible energy from the developing world’s educated youth and emerging middle class.

We are always here should you have any questions or wish to talk about anything related to your portfolio or your finances. We appreciate your continued trust and confidence.



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Let’s close by talking about volatility and portfolio direction.

Volatility

In 1907, U.S. financier J. Pierpoint Morgan single-handedly averted a banking panic among U.S. investors. Later in life, someone asked him his best guess as to the direction of markets. His answer: “They will go up and they will go down.”

One hundred years later, that’s still the best answer to someone looking for a short-term market forecast. No one can predict market movements in the immediate period ahead.

What we can do is understand clearly how much short term volatility we can live with, adjust our portfolios accordingly and stay focused on the horizon as we deal with the rough waters. No one likes volatility ... but for most of us it’s the necessary price to arrive at our ultimate destination.

Direction of portfolios

In the meantime, we are constantly looking for opportunities to realign portfolios to give our clients the best tradeoff between risk and return. Given the current uncertainty and volatility, we are continuing to focus on higher quality companies in both stock and bond portfolios and are maintaining a healthy weighting in alternative investments that have a lower correlation to the stock market and economy.