

# WOOD & WHITE

Investment Advisors, LLC

## Market Commentary

April 14, 2009

To our clients and friends:

Global markets entered 2009 in a tailspin, with many major asset classes coming off of their worst calendar-year performance in over 70 years. Markets deteriorated further in the first two months of 2009. Fears of a broad nationalization of the U.S. banking system further fueled the seemingly endless market panic, knocking major market averages even lower. As of March 9<sup>th</sup>, the S&P 500 Index stood a whopping 56% below its all-time high, while the Dow Jones Industrial Average had dropped 13% below its previous bear market low set in October of 2008.

**However, in the final weeks of the first quarter, long-suffering investors were given a refreshing taste of the market's recovery potential.** Positive forecasts from the heads of several major U.S. banks, along with long-awaited clarity from the U.S. Treasury on its plan to cleanse toxic assets from the financial system, eased fears of a systemic collapse and sparked a furious rally to close the quarter. The Dow Jones Industrial Average and the S&P 500 Index both recovered to post total returns of over 8% during the month of March. The market still closed the quarter in negative territory, its 6<sup>th</sup> consecutive quarterly decline, with the S&P 500 posting a total return of -10.9% and the Dow Jones Industrial Average down 13.3%. Small-cap stocks and international markets fared similarly, with the Russell 2000 down 15.4% and the Dow Jones World Index, excluding the U.S., down 11.7%.

**Market activity in the month of March and early April suggests that the "bottoming process" that began last October may have run its course.** In light of the current attractive valuations and evidence of more rational and stable market behavior, **we will be buyers in the equity market in the coming weeks and months, gradually positioning client portfolios more aggressively.**

While it is impossible to time a market bottom (and we will not attempt to do so), **we believe that current market prices present significant opportunity for long-term appreciation.** We can sight the following variables - some new, some included in our commentary from the fourth quarter of 2008 - as the basis for our optimistic view:

- In November of 2008, the dividend yield for the S&P 500 Index surpassed the yield on 10-year Treasury bonds for the first time since the 1950's. **As of the writing of this letter, the dividend yield for the S&P stands at 3.37% vs. 2.85% for the 10-year Treasury – a spread of over 50 basis points.** The past 17 months of pain in the stock market has led to a mass exodus from equities into what could be the worst performing asset class (Treasury bonds) for many years

- to come. At some point in the future, investors' risk appetite will return. When it does, we believe the investment returns offered by common stocks will dwarf that of risk-free assets.
- The U.S. Treasury and the Federal Reserve, in concert with central banks and government agencies around the world, have taken the boldest steps since the Great Depression to restore confidence and reflate the economy. While there may be some adverse unintended effects from the unprecedented levels of government intervention and stimulus, **it seems clear to us that recent government actions are helping restore liquidity to the marketplace, which should provide a boost to near-term economic activity.**
  - Long-term mortgage rates have declined to the lowest levels on record, and the Federal Reserve seems intent on pushing rates even lower through its purchases of mortgage-backed securities and long-term government bonds. This reduction in borrowing costs should help repair consumer balance sheets over time and, most importantly, **should contribute to a stabilization in housing prices.** Finding a floor in home prices is a critical step towards pulling out of this crisis, as housing represents the collateral backing a huge share of the troubled assets clogging the balance sheets of U.S. financial institutions.
  - There are articles appearing weekly in financial publications proclaiming the “death” of buy-and-hold investing. It seems as though every ounce of optimism has been wrung out of the American psyche and the long-term viability of capitalism itself has been called into question. In our day-to-day interactions it is difficult to find anyone who believes that the recent market rally is sustainable. Throughout history it has paid to be optimistic when others are fearful. **We believe the current level of pessimism augurs well for the sustainability of the recent turn in the market.**
  - While sentiment overall remains overwhelmingly bearish, we see subtle signs of a nascent recovery in investor risk appetite. For many months the marketplace has treated all risky assets uniformly, with little or no regard for differences in quality. In recent weeks investors have become more discriminatory, and we have seen a greater dispersion of returns across asset classes and within various segments of the global equity market. Perhaps more importantly, higher-quality segments of credit markets continue to thaw and the spread between Treasury yields and investment grade bonds has narrowed. This is a very positive sign that the market is no longer focused day-to-day on the risk of collapse. **We appear to be slowly reverting to a more rational environment** where potential risk and reward are evaluated and discounted into market prices on a case-by-case basis.
  - In reviewing U.S. stock market returns for the past 198 years, the period ending December 31, 2008 produced the lowest annualized rate of return, at -1.5%, of any rolling 10-year period. Since 1810, whenever stocks have posted an annualized rate of return of less than 2.5% for ten years, the annualized rate of

return for the following 10-year period has averaged 13.3% (*source: Capital Research and Management Company / Global Financial Data*). **We believe, and history suggests, that the recent 10-year span of negative returns for U.S. equities may have laid the groundwork for a period of above-trend performance.**

- According to the National Bureau of Economic Research, the current recession began in December of 2007. Since 1900, there have been 21 recessions in the U.S. with an average duration of 14.4 months. Throughout history, an improvement in stock market performance has traditionally preceded an upturn in economic activity by several months. Given that we are already 16+ months into the current recession, **we expect stock market performance to improve through the balance of 2009 in anticipation of a more stable economic environment.**

We have resisted the urge to buy aggressively for many months. For all of the reasons above, we are transitioning to a more offensive mindset in the management of client accounts, subject to a sufficiently conservative provision for liquidity and capital preservation. We may not realize the full benefit from purchases made today for several years hence, but we believe the table is set for solid long-term performance.

We welcome your comments and questions at any time. Thank you for your friendship and for your support of our firm.

Sincerely,

**WOOD & WHITE INVESTMENT ADVISORS, L.L.C.**



**Charles B. White, CFA**



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