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Friday, February 27, 2009

## **When will the stock market bottom?**

It is Friday evening, the last business day of February in what has started out to be another year of dreadful declines in the stock market. Tonight, the Dow Jones Industrial Average rests at 7062 and the S&P 500 Index is 749 - fully 52% below its value on October 12, 2007, when this bear market began.

I have experienced two bear markets in stocks of this depth, one in 1973-74 and the other in 1981-82. Both of those occurred during times of roaring inflation and were accompanied by exploding interest rates. This creature, on the other hand, is of a deflationary nature so it's the exact opposite financial ailment. To be sure, we have for years sensed that unlike the vast majority of our FLK clients, many people have been living well beyond their means for many years now and not only spent most or all of what money they had, but also leveraged themselves for consumption. Those individual and societal chickens have come home to roost now and to varying degrees, we are all paying the price for those profligate ways.

Every day we are asked when the stock market will bottom and our most forthright response is we do not know. We do know however that after a 52% decline in the major stock index a huge amount of any excess has been rung out and that somewhere out there a turn will come and it could initially be dramatic in nature. We point out on the enclosed graphic presentation that what has happened in the equity market is nearly a four standard deviation event and that is akin to a 100 year flood or a 12 on the Richter scale so to speak, as it's statistically likely to happen in less than one half of one percent of all measured time periods. The critical point is that this is an extremely rare event and it is likely a very serious mistake to project the same intense decline going forward. We say this with full understanding that you and we are both uncomfortable with this environment and how it makes us feel, but our experience tells us that the point of maximum discomfort could well be the point of maximum opportunity.

Are there any signs of better times? Yes, there are straws in the wind. The credit markets for high quality debt are definitely functioning again and companies and municipalities are selling bonds and refinancing unlike late 2008 when credit markets were essentially frozen. Mortgage rates are finally lower and very attractive for qualified buyers, but the supply of existing homes for sale now stands at thirteen months which is twice what is normal so it will take an extended period to work off inventory. Energy prices while still very volatile give off some indications of having seen their lows and gasoline demand is slowly rising again in the U.S.

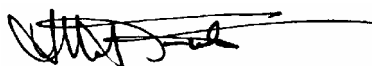
The biggest current negatives are:

- 1) unemployment (which is a trailing not a leading economic indicator) is likely to rise throughout this year even if the economy bottoms soon;
- 2) the curse of the 24 hour news cycle which screams negativism into our homes and lives constantly;
- 3) the deleveraging cycle which will likely go on for a long time as extensively indebted entities work through their personal or corporate rehab and;
- 4) the uncertainty and changes created by a massive political shift which will in some cases reverse winners and losers in our system all while changing priorities about what we as a society need to focus on. This change in the political realm seems to be nearly unprecedented especially when layered on top of the current economic problems. Meanwhile investors wonder, will we be able to float all the debt the government needs to absorb without eventually crashing the dollar or pushing interest rates much higher over time? We do not know, but we will definitely find out.

We do know a positive fact in the long-run: the unique American entrepreneurial spirit and determination to have a better life that has allowed this country to go through long periods of wrenching change before and come out on the other end better for the experience. Admittedly, we need some luck in the weeks ahead, but over 90% of those in the workforce are still working and the vast majority of us are not about to lose our home to strapped creditors eager to snatch it away from us. Most of us also realize that a house is a place to live in, not a piggy bank and whether it is worth more or less than we paid for it is academic unless or until we need to sell it and even then it is not likely to make or break most of us financially. (Sorry CNN, that's the plain truth from the heartland).

So when will the stock market bottom? We do not know. But we do believe that patient and well diversified individuals, living below their financial means, are likely to see another day when their net worth is rising and they are not being told every day that the world is ending. Excess can breed big opportunity or increased risk and our sense is that we have been through the worst of the excess behavior part and the next phase will likely be much better, but admittedly it may be next year or even later before we can confirm this view.

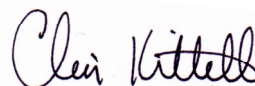
Sincerely,



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Written by Mike Finkle February 27, 2009. All opinions expressed herein are strictly those of the author and FLK and not official views of Raymond James & Associates. Figures quotes are obtained from sources deemed to be reliable but are not guaranteed as to accuracy. Past performance does not guarantee future results. Investing involves risks and you may incur a profit or a loss. Long-term investing does not ensure a profitable outcome. Standard deviation is a measure of risk of individual securities or portfolios. It is a statistical measure of the volatility of rates of returns i.e. the degree to which returns vary around the average return.