Investment Watch

1st Quarter, 2007

MARCH MADNESS

March should be the time for **madness** - NCAA basketball **madness**. But this year the madness started early on February 27th and not with a basketball and not here at home. It started half-way around the world in Shanghai. While we slept, China's *Shanghai Composite Stock Index* plummeted almost 9% in just one day.

Actually this was not madness at all. Chinese stock markets had moved up too fast by more than 30% since January 1st and 150% in the last 12 months! Even after the 9% decline, they were still up over 20% for the year. A 9% decline after rising so far and so fast should have been expected. But just like diehard fans during double overtime, investors' emotions were running high.

And so, what happened next was **madness.** The news media sensationalized the event blowing it out of proportion, instilling investor fears. The madness precipitated record volume, rocking the US stock market as the DOW plunged 416 points. The madness spilled over to stock and bond markets around the world. Unlike the Chinese markets, which lost only one-third of their 2007 gain, the US stock market's year-to-date gains were wiped out completely in just a few days. Despite the madness, we must stay focused. A few point deficit can easily be overcome and even turned into a lead.

Since when does the huge, number 1 ranked, New York Stock Exchange react so wildly to the upstart, 16 seed, Chinese market? We could blame it on March Madness, but maybe the media is to blame, or maybe we've become complacent with the lack of volatility in the US stock market. From our reaction, it seems even small global events can trigger the madness.

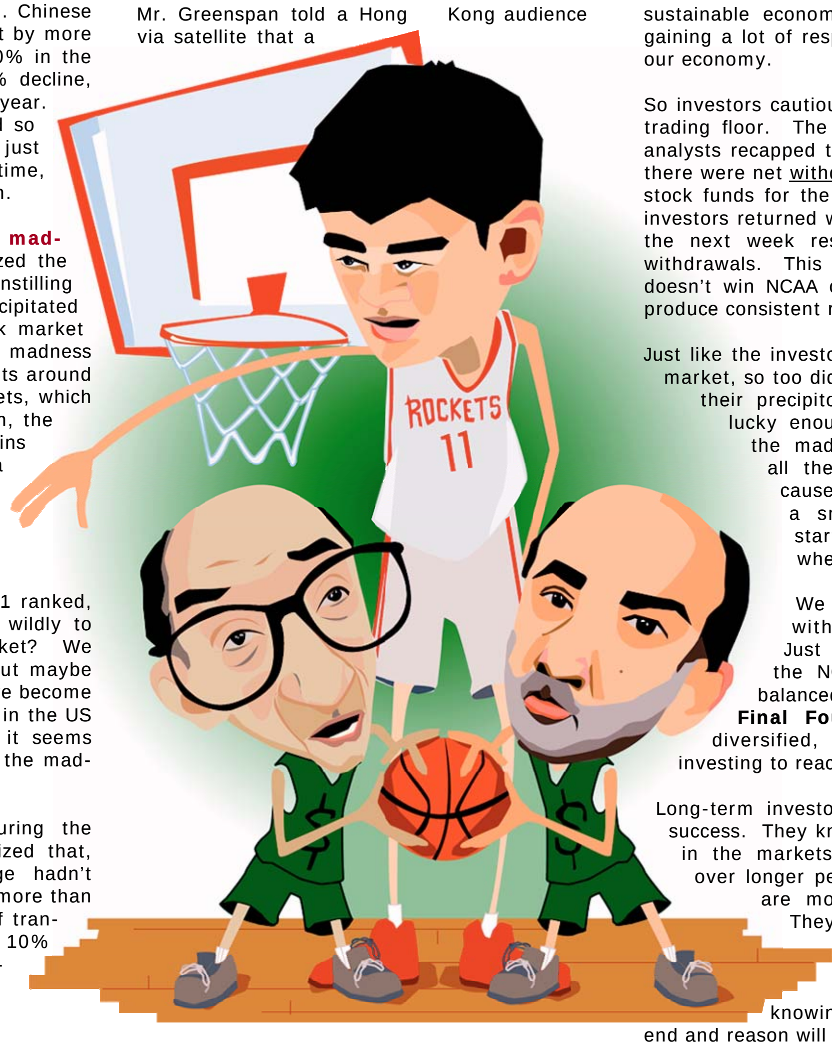
A Wall Street Journal reporter during the depths of all this madness, recognized that, "the Dow Jones Industrial Average hadn't fallen as much as 2% from a high in more than seven months", the longest period of tranquility since 1954! "And hadn't fallen 10% in almost four years. That is an exceptionally long time without a hiccup."

A ***"market correction"*** is usually defined as a drop of 10%, but less than 20%. A correction implies that the market gains too much in value, overshooting the "correct" value, and then goes down correcting to the right value. Generally these 10% market corrections happen about once per year. But as the reporter explained, the last "correction" was about four years ago at the beginning of 2003.

Some investors may not realize how tranquil the stock markets have been over the last four years. They may still have those unpleasant memories of the staggering losses when the tech bubble burst. These old memories are hard to forget, so the recent tranquility may have made investors more anxious. Just like those edgy fans in those close NCAA games, investors are jumpy and react hastily to any news.

Could a correction happen? Sure. Could a recession happen? Well, former Federal Reserve Chairman Alan Greenspan (pictured on the left) may have contributed to all of the uneasiness by expounding on the future prospects of our economy.

Mr. Greenspan told a Hong Kong audience via satellite that a



U.S. recession was possible this year. "When you get this far away from a recession, invariably forces build up for the next recession, and indeed we are beginning to see that sign," he said. Although he backpedaled, indicating that there is not much of a chance during 2007, the mere mention of the "R" word ignited the media and the media inflamed the public—March Madness.

Greenspan, even though retired, wants the ball back. He still has considerable influence and with his usual cryptic language known as "*Greenspeak*", he stole the ball from his successor, our new Federal Reserve Chairman, Ben Bernanke (pictured on the right). But Bernanke, just like a good coach tries to take pressure off his ball club in their first final four appearance, soothed the market's jitters with calm words to the House Budget Committee.

During Congressional testimony, he explained in plain words that the financial markets seem to be working well and that his outlook for moderate economic growth has not been shaken. "Incoming data has supported the view that...current policy is likely to foster sustainable economic growth." Bernanke is gaining a lot of respect in his ability to coach our economy.

So investors cautiously stepped back onto the trading floor. The Banc of America Security analysts recapped the madness reporting that there were net withdrawals of $3.3 billion from stock funds for the week of March 7th. Then investors returned with deposits of $3.0 billion the next week restoring almost all of the withdrawals. This kind of helter-skelter play doesn't win NCAA championships nor does it produce consistent returns in our 401(k)s.

Just like the investors' money returned to the market, so too did the markets recover from their precipitous decline. If you were lucky enough to have missed all of the madness, you'd wonder what all the hubbub was about, because we ended the quarter just a smidgen above where we started. A wild ride to nowhere.

We are long-term investors with long-term objectives. Just like a basketball team in the NCAA tournament needs a balanced attack to make it to the **Final Four**, so too do we need a diversified, consistent approach to investing to reach our financial goals.

Long-term investors have a game plan for success. They know that short term swings in the markets are not predictable, but over longer periods of time the markets are more consistent and stable. They know that diversification reduces risk. So they ignore the buzz about the short term swings knowing that the madness will end and reason will prevail.

March Madness brings excitement to many sports fans, but let's all hope that the madness stays on the basketball court!

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