

SignPost: Is the glass half empty... or half full?

When the news these days is screaming “Market Meltdown!”, it seems as if everyone is rushing for the exits and selling stocks in a panic. It’s easy to forget that **every trade involves both a seller and a buyer**. It might make you wonder, with so much negative economic news being announced daily, who is buying, and why now?

The short answer is: it’s the so-called “Smart Money”, those investors who see the current bad environment as a temporary opportunity to acquire valuable assets at great prices.

We are not making light of the intestinal fortitude it takes to be buying stocks in the current environment. But truthfully, careful analysis of daily stock market action reflects that much of the selling is either forced or involuntary (which we discuss below) or it is driven by strong emotional sentiment. Buying, on the other hand, is driven by different motives. Buyers simply see the glass as being half full, not half empty. And regardless of whether the daily market drama might continue for some time, they are basing their decisions on the **rules of fundamental value**. They are buying stocks because they believe their patience and foresight will ultimately reap rewards.

So, raise your half-empty glass and consider whether perhaps it might actually be half full. Here are a few reasons to think so:

- Market Volatility Creates Opportunity

Highly-leveraged investors, such as investment banks, hedge funds and brokerage houses, have **no choice but to reduce their leverage**. In fact, their forced selling has become the norm recently, especially near the end of the trading day. Involuntary sellers care less about price and more about needed liquidity, so they take almost any (mostly low) price available. That is why wild negative volatility has frequently been so dramatic in the last hour of trading. It certainly has nothing to do with fundamental value. The flip side is that this volatility is this: it creates a tremendous buying opportunity for patient, long-term investors. In fact, as providers of liquidity, they are accumulating stocks at excellent prices.

- Recent G20 Meeting

A very encouraging sign from the recent G20 meeting is that there is unprecedented co-operation among countries to do whatever it takes to reboot the global economy. For example, they have agreed not to impose any new trade tariffs for the next 12 months, thus maintaining a **free flow** of goods and capital.

➤ Global Monetary Stimulus from Central Banks

Central banks around the world are lowering interest rates and increasing their money supply. These **lower borrowing costs** are being passed on, not only to banks, but also to businesses and consumers. This effort supports and builds demand for goods and services in the economy. And, they can cut interest rates further if need be.

➤ Global Fiscal Stimulus

Governments around the world have announced billions of dollars in new spending. Such spending, whether for infrastructure projects or help for banks and industry, will help **stimulate overall economic activity**. It is also encouraging to see the speed with which these plans are being undertaken. Quick action will speed up the time frame for an eventual recovery.

➤ Valuations

In previous commentaries, we have discussed the fact that equity valuations are at the lowest levels in decades. There are various metrics related to valuations, such as price/earning ratios, price/book value ratios, etc. Of particular interest lately is dividend yield. For example, recently, the **dividend yield** of the stock market has increased to a level above the 5-year government bond. This is the first time that has happened since 1957!

➤ Historic Bull/Bear Markets (see attached chart)

Research on previous bear markets in global stock markets suggests that they typically last 13 months, with a decline of 24%. The current bear market is more severe: it has now lasted 22 months and has declined over 40%. Nevertheless, and we take no comfort in saying so, the recent bear market is not without precedent. More importantly, the recoveries from bear markets have lasted an average 44 months with average returns of 133%. This is not a forecast that a market bottom has been reached, but, it is now **a waiting game**: the longer a bear market persists, the closer the next bull market inevitably is. Think **half full**.

In conclusion, let us say we fully appreciate the anxiety that this recent market downturn is causing many investors. Frankly, some of the day-to-day volatility is astonishing and the best experts are at a loss to explain it. It doesn't really make much sense from an economic perspective, for it is extremely unlikely that future corporate profitability, which drives stock prices over the long run, will prove to be even remotely as volatile as the recent stock market volatility would suggest.

Not to sound like a broken record, but we can only say again: patient investors will eventually be rewarded handsomely for staying the course during this most difficult time.

Bull and Bear Markets

MSCI World Index, Net Dividends (CAD)

Monthly Returns: January 1970-October 2008

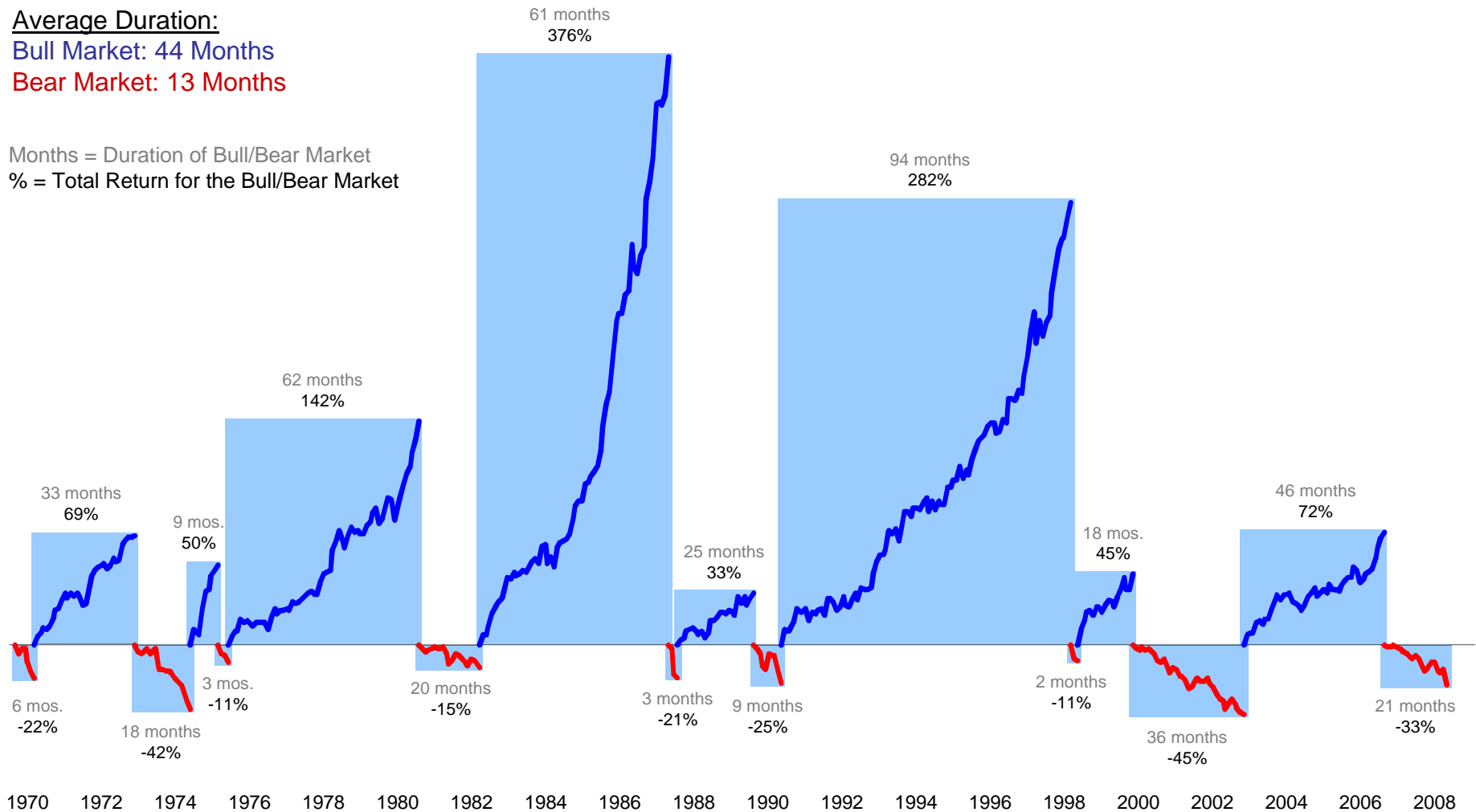
Average Duration:

Bull Market: 44 Months

Bear Market: 13 Months

Months = Duration of Bull/Bear Market

% = Total Return for the Bull/Bear Market



MSCI data copyright MSCI 2008, all rights reserved.

Bull and bear markets are defined in hindsight using cumulative monthly returns. A bear market (1) begins with a negative monthly return, (2) must achieve a cumulative return less than or equal to -10%, and (3) ends at the most negative cumulative return prior to achieving a positive cumulative return. All data points which are not considered part of a bear market are designated as a bull market.