

WJM FINANCIAL, LLC

Fee-only financial planning and investment management

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Comments on recent market turmoil

Investors woke up yesterday morning to discover that (1) Lehman Brothers had filed bankruptcy, (2) Merrill Lynch was being purchased by Bank of America, and (3) AIG was restructuring in an effort to shore up its finances and avoid its own crisis.

Not surprisingly, domestic and global stock markets responded poorly to the news and most major markets were down 4-5% by the end of the day. The news and associated losses caused understandable anxiety for investors who were already jittery after the government's takeover of mortgage giants Freddie Mac and Fannie Mae earlier this month, and the near collapse of Bear Stearns earlier this year.

In the wake of these events, concerns remain about the state of the US and global economies, how the liquidation of Lehman Brothers' assets will affect the prices of other securities over the short-term (probably not in a positive way), and the potential impact of further business failures if they materialize.

Given all of this uncertainty, the natural inclination is often to run for cover. I do not have a crystal ball, and I cannot predict the future, but I do not believe that fear induced selling is prudent. To quote Warren Buffett, "when everyone is scared and selling, it may be time to buy. When everyone is greedy and buying, it may be time to sell."

Past financial crises

Every crisis is different, and it is impossible to make an apples-to-apples comparison between what is going on today to what happened during other periods. However, history provides valuable perspective that can be easily lost while living through today's crisis. It is important to remember that we have experienced and weathered many financial crises before, and we will weather this one as well.

Consider the following list of crises, which is far from exhaustive:

- The crash of October 19, 1987 when the saw the stock market drop 22% in a single day (Black Monday).
- The Savings and Loan crisis of the late 1980's and early 90's that resulted in the failure of over 700 institutions.
- The collapse of Barings, London's oldest bank, in 1995.
- The collapse of Long-Term Capital Management in 1998 that threatened a meltdown of our entire financial system.
- The deflation of the stock bubble and the dot.com crash from 2000-2002.
- The attack on The World Trade Center towers in 2001, and the fear of additional attacks on our financial systems and our way of life.
- The collapse of Worldcom and Enron, and the accompanying accounting scandals of 2002 that also brought down Arthur Anderson.

Now consider this...if you had invested \$100,000 at the worst possible time, the day before the October 1987 crash, and then weathered each of the above crises – not to mention two recessions, two wars, a global financial meltdown in 1997, the currency devaluation of numerous countries, the default of Russia's private and public debt, and the current market downturn, subprime crisis, and deflation of the housing bubble – you would have earned 9.1% annualized, and your \$100,000 would be \$627,000 today (even after yesterday's downturn).

Additional thoughts

- Our planning intentionally builds in cushions to account for market downturns by (1) assuming investment returns that are below historical average rates, and (2) stress testing our results to see what impact short-term losses might have.
- For investors who are in or approaching retirement, we include an allocation to cash and/or high quality bond funds that is equivalent to at least 3-5 years worth of projected withdrawals so that we can weather most storm without forced liquidations.
- For investors who are actively contributing to their portfolio, a short-term downturn should have little effect on long-term portfolio accumulations, and may actually enhance accumulation values.
- Market volatility and downturns on their own should not dictate portfolio strategy. However, changes to your planning objectives or risk tolerance may. It is impossible to know how you will feel about market downturns until you experience one, so please let me know if you think that your risk tolerance may be different than we previously assumed.

Please do not hesitate to contact us if you are concerned about how this downturn might affect your planning.

Sincerely,

Bill