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Current Economics

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In the second half of 2008 we experienced dramatic volatility in all stock markets and at the same time credit activity through our financial lending system came to a halt. Many experts and commentators have made comparisons of our current economic climate with recessions of the past, and even the depression of the 30's. While some common ground does exist and there are always lessons to be learned from history, in many ways we are currently navigating uncharted territory.

Here in 2009 we have started the year off with a roller coaster market. After a rally at the end of 2008, the bear market returned, diving below its 2008 lows in early March. However, the stock market closed the quarter with a strong, 20%+ rally. Have we missed the bottom? Consider:

- Mortgages and credit card debt alone totaled $13 trillion or 123% of after tax income in 2008. In 1995 it was 83% of income.
- The total amount of mortgage credit was down in 2008 for the first time since the Fed started keeping track in the 1950s.
- The Fed data also showed that the net worth of U.S. households stood at $51.48 trillion at the end of 2008. That is down 17.9% from a year earlier and down 9% from the end of third quarter alone.
- The collective portfolios for all Americans investing in stocks and bonds in the fourth quarter of 2008 were $8.76 trillion, which has decreased roughly 16% in the first quarter of 2009.
- The Fed said recently that U.S. household net worth tumbled by $11 trillion in 2008 – a decline in a single year that equals the annual output of Germany, Japan, and the U.K. combined.

Many young families, because of these tough times, are coming to terms with the fact that there may not be big pensions at the end of their career rainbows. The good news is that they are realizing the importance of investing long term and are starting to save income rather than spend it, putting money into their 401(k)'s or 403(b)'s. Having a giant house to live in is not as important to them this year as it was last year, and living within their means has become fashionable again. We applaud the families who are working hard to do just that.

Areas to be watching

Because of the current market, investment managers are very bullish on corporate bonds. The credit crunch has created some compelling values, especially when compared with expected returns on U.S. Treasuries. These managers are also bullish for the lower quality high-yield bonds that are available today, which present some great opportunities though they do add a measure of extra risk.

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Current Economics *(continued)*

The yields on municipal bonds are also attractive, but many analysts are concerned about cities and states running large budget shortfalls. There may be some risk of them not making their interest payments or paying off bonds at maturity, which is concerning.

Many economists are worried about the possibility of inflation because of all of the new cash that is going into the system. Investment managers are closely watching commodity products such as oil, natural gas, coal, copper, gold, and timber. These commodities can help offset inflation and provide more diversification. Further devaluation of the U.S. Dollar is also a possibility, so they recommend investments that can hedge against the U.S. currency.

Many investment analysts agree that the market is probably testing its bottom and that during the next 6 to 12 months it will move higher, though there is still the possibility of the bear market extending its reach even further. As the economy slowly gets stronger it will be important to not only own assets that provide safety (such as corporate or municipal bonds, preferred stock that pays dividends, money market funds, and treasury bonds), but also to continue to have exposure to equities in the small cap, mid cap, and large cap categories.

In our opinion, sitting on the sidelines and holding sizable amounts of cash and bonds is a safe place to be right now. We also firmly believe that the current economic downturn will not last forever. We recommend that our clients look down the road 12 to 18 months anticipating how inevitable change will impact their net worth, annual income, wealth management, income taxes, inflation, and many other financial factors. Prudent investors will need to monitor a broader range of financial vehicles in order to protect their assets, and purchasing power, over the long term.

Gary Pittsford, CFP®, is President and CEO of Castle Wealth Advisors, LLC. Castle specializes in helping families and closely-held business owners with valuations, succession planning, estate and income tax analysis and retirement income projections. Castle's senior partners work with clients throughout the country in making logical decisions that help them fulfill their personal and business financial goals. For more information visit www.castle3.com, call 1-888-849-9559 or e-mail Gary directly at Gary@Castle3.com.

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