the BENEDICT *BRIEF*

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Benedict Financial...What's Happening Around Our Office?

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Calls in: "I don't think it's like before, it's different this time." "In all my years, I've never felt like this." "Our neighbors can't even afford the necessities." "I'm worried and I'm scared."

Phil's Comments:
Slow down a bit. There are many individuals and many families who are worried and scared and have reason to be. But, for the economy as a whole, the worried and scared description is probably way too strong. For families who do not have unreasonable debt and their consumption is within reason, the worried and scared description is definitely too strong.

Let's break down the fear into major areas:

THE RECESSION

It certainly feels as though we are into a global economic slow-down, at least for several months. And, when the slow-down changes course it may still feel slow, because it won't have the economic firepower of the last few years that was fueled by the housing boom. But, that doesn't necessarily mean the end of the world as we know it. In fact, it is a very natural part of the economic process.

In this country the residential real estate market went through an almost unbelievable and totally unreasonable burst of enthusiasm that just kept building on itself until the bubble popped. Houses do not double in market value in a few years! Houses are not liquid assets that one can sell in a few days and mortgages are not short-term feel-good relationships with a lender. Many of the players in this game got to believing that the fairy tale was the real world. Now, many of those players are suffering...many are suffering rather severely.

I have a lot of empathy for their suffering, but like watching a friend with a severe hangover on New Year's morning, there is not much I can do to lessen his suffering. But, that doesn't mean he won't want to share his suffering with all around him.

THE BANKING CRISIS:

"...but it is different this time, what about all those big banks going bankrupt?"

We witnessed this in the late 1970's as the government *bailed-out* the big banks that had made millions of dollars of loans to Latin American governments only to find (surprise) that they didn't have the ability to repay the loans. The solution was the Brady Bonds...that were more or less created by the government. The key innovation behind the introduction of Brady Bonds was to allow the commercial banks to exchange their claims on developing countries into tradable instruments, allowing them to get the debt off their balance sheets. (Sound anything like today's sub-prime crisis?)

We witnessed this in the late 1980's as savings and loans all over the country suddenly realized that many of the real estate loans they had made were never going to be repaid. The property values securing the loans had plummeted and the borrowers had no ability to repay. The economic pain was followed by the revelations that there were also a few fraudulently issued loans, thus many bankers went to jail and many politicians were implicated as part of the conspiracy. The solution was facilitated by the Resolution Trust Company which was created by the government in 1989. It is estimated that nearly 750 Savings and Loans went out of business during this crisis.

Today we are in the middle of a severe credit crisis that is impacting much of the western world. But, to say it is totally different this time, I don't think so.

THE MORTGAGE CRISIS

"...but normal people are going to lose their homes this time. I've never seen that before."

I agree and don't really know what to say. We preach to have three to six months ***reserve*** in a savings account. Many of today's families have nothing in savings, in fact, due to credit cards many of them are already in-the-hole equal to three to six months of income. Many went out and bought an expensive home with no money down and a thirty year commitment based on a very short-term interest rate. I feel sorry for these families, but this was very reckless financial management no matter what the marketing people were saying at the time. Sometimes you take your chances and you suffer the consequences.

THE STOCK MARKET

"...shouldn't we protect what we have, by taking everything out of the stock market and wait until things get better?"

We felt stock market valuations were reasonable last September, nothing like the year 2000, and they are now significantly cheaper. Many people would argue stock valuations are very attractive now. We agree with that. But, we are in the midst of an economically trying time that is filled with emotions that are fanned by the media and the political candidates.

We are assuming that we are more than halfway into the "bear" market. [In financial lingo a *bear* market is a downward trending market and a *bull* market is upward trending.] It would not be surprising to see a rally in the next few weeks followed by another downward spike before the healing really begins. But, we are only guessing.

OUR PLAN?

Our plan has been to sit tight in most cases. The only way we know to *beat* a "bear" market is to use it to buy into stocks at depressed prices. Thus, over the next few weeks we will be looking at selling some of our holdings that held up fairly well and use the proceeds to buy what appear to be real *bargains.*

We haven't considered moving a large part of our accounts to the money market account and wait for the bottom of the mark to reinvest. This strategy is very dangerous to long-term investment results and we are not capable of doing it successfully.

I am pretty sure that most of our clients would like to be out of the market, but bear markets are followed by bull markets, just like spring follows winter. I guess we are sitting tight waiting for spring, because the stock market usually turns around about the time the pain feels most intense. We have no logical choice but to be patient while searching for real bargains.

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