

March 31, 2008

### **A Rough Beginning to 2008**

Economic concerns and soaring energy prices combined to whipsaw the stock market during the first quarter of 2008. While this is not the first quarterly pullback stocks have experienced since the beginning of the latest bull market in late 2002, it is the most severe. The bond market posted gains as interest rates dropped in response to the slowing economy. There are many questions being asked about the capital markets and we will do our best to answer the most common ones.

**Are we in a bear market like the one that lasted from 2000 through 2002?** While it is impossible to know what will happen in the future, we are confident that this is not a secular bear market like that one was. Over the past one hundred years, we have only experienced three secular bear markets and they have all come after historic bull markets that drove valuations to record levels. Going into this slowdown, valuations have fallen an unprecedented 50% from the record levels seen in 2000. This should provide a cushion to stock prices.

**Should the Fed be bailing out Bear Stearns and other investment banks?** This is a question that will be debated for years to come. Trust in our banking and financial sector is what makes our economy run the way it does. When that trust evaporates in the form of a sudden loss of liquidity, companies can collapse with startling speed. While we are rarely fans of government bail outs, we feel the Fed did the correct thing to restore trust in the system to allow it to continue working. Expect to see increased government regulation after the dust settles.

**Is the falling dollar a bad thing?** This depends on who you talk to. The falling dollar helps our capital goods export sector, which is growing and hiring new workers. It is a negative for import prices, inflation, and for those who use basic commodities. While we want a strong dollar, this is not the problem some would have you believe.

**Is the housing slump almost over?** Probably not. This is a sector of the economy that saw huge gains over the past seven years, and it will take more than a few months to get back to reasonable levels. The remainder of this year will see large amounts of mortgage rates resetting which will likely keep pressure on housing prices.

**Are we in a recession?** We could very well be in a recession, although we often don't know we are in one until it's almost over. If we are not in a recession, we are standing on the edge of one. If we are in a recession, the severity and length of it will largely depend

on the housing slump and the mortgage crisis. In most cases, stock prices bottom out well before the end of the recession.

**Should we buy commodities?** After the recent run up in all commodity prices, we think prices are extremely over valued. The past few months of gains in commodity prices has been fueled solely by speculation rather than demand. In the short term they may trade higher, but we think they are a bad long term investment at these levels.

**How are the employees of Wabash Capital invested?** The same as you are, with no exceptions.

**Will stocks ever go back up again?** This is the question we hear the most and is also the one we are the most confident with in our answer. The answer is yes, stocks will be fine. The history of the stock market is one filled with corrections, bears, panics, corruption, bubbles, and anguish. It is also one of the greatest wealth generators ever created. Corrections like the one we are experiencing now, while not pleasant, are a normal part of investing in the stock market. Every correction throughout history has left investors questioning the wisdom of buying stocks. Successful investors look beyond the current troubles and see opportunities in the future.

History also teaches us that it is very difficult to predict market bottoms. Since 1950, the U.S. stock market has declined more than 13% over a three month period on ten different occasions. In eight of these periods, the market rebounded by more than 20% over the following twelve months. Because these rallies come quickly and when they are least expected, investors are almost always better off staying invested rather than trying to predict market tops and bottoms.

You may have other questions that we did not address in this letter. If so, please do not hesitate to call us. We understand that market cycles like the one we are in now can be unnerving. If you would like to readdress your long term investment plan, please let us know.

**Wabash Capital**