

Markets



Recession Already Priced In?

ALTHOUGH NOT NEARLY AS BAD AS JANUARY, February ended lower after a sharp sell-off on the last day.

For the month, the DJIA closed down 2.8%, the S&P 500 Index down 3.3% and the Nasdaq Composite Index declined 5%. The EAFE Index gained 1%, due entirely to the strength of the euro against the dollar.

Global markets are responding to fears of recession and or stagflation, stoked by slower growth and surging commodity prices, particularly oil. So far this year, the broad market S&P 500 Index is down nearly 10%, the worst start to a year in recent memory. For the past 12 months that index is now negative. The DJIA is the only major U.S. index positive for the rolling 12 months, up 2% through February.

But take heart in knowing that the stock market is forward looking. Markets typically decline as the specter of an economic downturn approaches, but they tend to stabilize as the downturn takes hold. Most importantly for investors, markets usually rebound significantly from the economic trough. The S&P 500 Index rose 24% on average in the six months following 10 of the last 11 recessions. The one exception was 2001 when stocks were overvalued heading into the downturn. Today, stocks are relatively good value compared to historical valuations.

Markets this year have experienced greater volatility than in recent years, but history also tells us that this is normal. Certainly stock markets can be volatile for short periods, but over time patience and discipline are rewarded. Don't focus on short-term market turbulence and lose sight of your long-term financial goals. That said, if a jolt of several percent in your portfolio causes alarm, you may want to revisit your asset allocation. If you have less appetite for risk, you might consider reducing your equities or take a more defensive posture to buffer the shocks the markets will offer.

Always Some Winners

As is usually the case in down markets, some funds brought in good returns in February: With commodity prices soaring, natural resource funds gained 11% on average, the top performing domestic fund category, followed by gold funds, up 10%.

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Energy and materials funds were strong. Most mid- and large-cap growth funds eked out small gains. Financial and telecom funds were among the weakest.

Outside the U.S., Latin American funds performed best while China and Southeast Asian funds also bounced. Diversified emerging markets funds gained 7% on average and many large, developed market international funds, except Japan, ended the month ahead.

Internationals once again got a boost from the weak dollar, which was weighed down by concerns about the U.S. economy and the Federal Reserve's interest rate-cutting campaign. Lower U.S. interest rates tend to weaken the dollar. And a weak dollar tends to support high oil prices. Commodities offer a hedge against a falling dollar, and oil futures bought and sold in dollars are more attractive to foreign investors when the dollar is falling.

Remember, at the end of the day everything shows up in fund performance. As Upgraders, we don't focus on explanations or forecasts. We invest solely based on what is happening - what the performance ranks tell us, not what we think will happen. Upgrading is a quantitative process which keeps us objective.

By following the discipline we have a built-in flexibility to respond to changing market conditions, no matter what.

For retired clients or clients with aged parents who are not filing tax returns because they don't have enough taxable income - they need to file a 2007 return to get the applicable tax rebate that will be going out starting in May 2008.

Thank you for your business,

P. Michael Valley II

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