Special Market Commentary

BRAGG
FINANCIAL ADVISORS

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Dear Friends,

Worldwide stock exchanges plunged again this week after falling over seven percent last week. As of yesterday's close, the S&P 500 is down 36% in price from its peak of last October while foreign markets are down more than 40%. Price declines have not been limited to stocks. Real estate, corporate bonds, municipal bonds and commercial paper have also fallen in value. Worldwide credit markets are not functioning properly.

All of us have an uneasy feeling when we see the Dow shed 500, 600, 700 points in one day. It is painful and it is hard to see past this crisis. Why are prices plunging? What is driving this?

The market is still dealing with the fallout from the credit crisis fueled by bad loans made to people who are now defaulting. Banks and other financial companies simply have too much bad mortgage debt on their balance sheets. Many of these loans will fail and financial companies find that their balance sheets and liquidity positions are in very bad shape. Market participants, including financial companies themselves, have become extremely worried about having the liquidity (cash) necessary to operate. Banks have stopped lending to borrowers and to one another in an effort to preserve their liquidity and this has caused our financial system to freeze up.

How can our financial system freeze up? When our financial system is operating normally, we deposit cash and the bank lends that cash to borrowers. When we have a crisis and we all want our cash in our hand, we have a problem; the cash simply is not there. This is a simple example but that is basically what is happening today in our financial system. Market participants are hanging onto their cash. When individuals, corporations and municipalities do not have access to cash, the economy is not able to function.

Another way to raise cash is to sell securities and that is what you are seeing on a massive scale. Financial companies, hedge funds, corporations and individual investors who are desperate for cash are selling securities of all types to raise cash. Hedge funds in particular have had huge redemption requests but so too have mutual funds and other investment vehicles. Some of these redemptions are driven by the need for liquidity but some of these redemptions are driven purely by fear.

While we too are anxious, we are extremely hesitant to sell our stocks or our bonds at these prices. We would rather sell our securities gradually over the twenty to thirty-year period that encompasses our retirement or when the funds are needed to fund college tuition. We could be wrong, but we think these prices are irrationally low and are driven by emotion. At the same time, we know that prices may go lower still. In fact we should tell ourselves they will. We do not have a crystal ball but we think we will look back in a few years and be glad we did not sell our securities at the prices they are trading for today.

My house is worth less than it was 12 months ago but I am not going to sell it as a result of that fact. I am getting a lowball offer on my stocks and bonds today but I will not sell at this price. I may be wrong in the short term but I think I'll be right in the long term.

Once again, you are hearing that our advice is to maintain a long-term view if you feel that your portfolio allocation is appropriate. By all means let us know if you would like to discuss this or if you would like to make a change.

Sincerely,

Benton S. Bragg

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