H. M. Payson & Co.

FALL 2008 ♦ SPECIAL EDITION

PERSPECTIVES

Across The Abyss

As we approach the final month of this traumatic year, the major indices have broken through what had been viewed as key support levels, once again disappointing investors hoping for a definitive bottom. Having counseled our clients to stay invested throughout this turmoil, we realize our message might be rather threadbare - but we continue to maintain that a) to sell into the teeth of a broken market would be enormously counterproductive, and b) the prospects for generous future returns for anyone with a multi-year horizon are immense. Furthermore, as the 18% rally from October 27th to November 4th so vividly demonstrated, market recoveries tend to be dramatic, and unpredictable. Our message is not "Don't worry, be happy" – the headlines are indeed sobering. Rather, as professional investment counsel it is our role to dispassionately and nimbly navigate the shifting investment landscape in search of value, and to position our clients' portfolios accordingly.

Evidence abounds that this is a dysfunctional market. On days when the market is down significantly, the bulk of the declines consistently occur within the last hour or two of trading – in many cases, in the last thirty minutes alone. Trading volume is relatively light, considering the magnitude of the moves. In addition, some of the largest declines are in the largest capitalization stocks. These are signs of forced liquidations by large institutions – primarily hedge funds and mutual funds, meeting margin calls and redemption requests at a time when buyers are sitting on the sidelines. Any rational individual knows that ExxonMobil losing 12% of its value *on a single day* (October 9th) has *nothing* to do with the state of the economy. These are institutional investors dumping liquid assets simply because they need to raise liquidity at any price.

For individual investors, this dynamic represents a rare turn of the tables. In sheer trading clout, institutions have the advantage of scale and access to information. Today, they are begging for cash as they attempt to reduce excessive leverage, and investors would be wise to help them out by taking a few unwanted shares of so many quality companies off their hands. If one is fully invested (as we usually are), the worst thing one could do is join them on the seller's side of a market with no buyers.

It is human nature to succumb to the temptation to flee to safety when asset values are declining. Yet, understanding the psychological aspects of market behavior is essential to long-term investment success. In March of 2000, the S&P 500 index was priced at such a level that it was discounting sales growth of 22% for the next five years.[1] As the market returns since then have confirmed (and as we opined in these missives at the time), this was a ridiculously optimistic assumption. Yet, at the time *everyone*, it seemed, wanted to own stocks - particularly technology stocks, which were the most egregiously overpriced. Today, by the same model, the index is discounting *negative 3%* revenue growth for the next five years – possible, perhaps, but highly unlikely in a modern economy.

[1] Source: Applied Finance Group, Ltd.

As shown in the accompanying table and in our last issue of *Perspectives*, investment values are abundant not just in equities, but in virtually every asset class *except U.S. Treasuries*. Despite depressed prices, however, investors are having as much difficulty recognizing the opportunities today as they did appreciating the risks back in 2000. The irony speaks for itself!

That being said, we do not intend to sit idly by and wait for a recovery. With the collective expertise of our investment, tax and planning professionals, we are actively repositioning portfolios. Historically, many of our taxable accounts have held large low-basis positions, and we have been judicious with capital gains. The current environment, however, provides a rare opportunity to aggressively utilize the tax benefits embedded in unrealized losses, improve portfolio diversification, and position accounts to take advantage of our best research ideas on an ongoing basis. For all accounts, the abundance of value in virtually all asset classes affords the construction of portfolios containing both growth *and* value characteristics, while meeting any mandate.

In the spirit of the coming holidays, we are inclined to reflect and count our blessings – not the least of which is an incredibly loyal group of clients, which we are privileged to serve. To all clients and friends, we wish you well, welcome your calls, and look forward to a much more pleasant 2009.

FROM REVERED TO DESPISED

	P/E 3/00	P/E 11/08	Dividend Yield 11/08
Coca Cola	38	13	3.7%
ExxonMobil	32	8	2.3%
General Electric	48	6	9.7%
Home Depot	62	9	4.9%
IBM	30	9	2.8%
Johnson & Johnson	27	12	3.3%
Microsoft	60	9	3.0%

If you have questions or comments regarding this or any other issue of ***Perspectives****,*
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