Economic Update

Broadleaf Partners, LLC

Ugly Days, Springboards, and Silver Linings

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On July 9th, the S&P 500 declined into official bear market territory, falling by twenty percent from the prior highs achieved in October of 2007. Make no mistake about it, these have been ugly days, perhaps far uglier than even the indices suggest.

According to work done by JP Morgan, of the 723 U.S. stocks that have a trading history going back to 1973, or 35 years, 51% are lower today than they were 10 years ago, 24% are lower than they were 20 years ago, and 9% are lower than they were 35 years ago. Adjusting for inflation, a ten year chart of the S&P 500 shows that investors would be underwater. While not unheard of, these times are unusual.

The good news, if there could be such a thing, is that bear markets are nothing new. In fact, they are quite common. Since 1900, there have been 31 bear markets, or about one every three or four years. Morgan's work also suggests that a key to how the market behaves twelve months after the onset of a bear market ensues is whether or not the bear market is accompanied by a recession. Without a recession, the indices have historically rebounded 25% over a twelve month period, but if they are accompanied by a recession, they have historically been 2% lower after the same period of time.

While the economy isn't officially in a recession today, the point is likely moot. It is hard to fathom that today's surge in oil to nearly $150 per barrel won't get us there soon, let alone today's concerns surrounding the solvency of Fannie Mae and Freddie Mac, the cornerstones of the U.S. mortgage market. It is quite clear that the housing problems are not totally behind us; the aftershocks are alive and well and can be visually seen in just about any bank stock you'd care to examine over the past six months.

The question, as always, is what do investors do about it now? Unless we are on the eve of the next Great Depression, there will likely be some new area of the market that leads the indices to a solid recovery. After the technology bear market and recession earlier in the decade, housing, financial and commodity oriented stocks carried the indices to new highs. In the absence of all out deflation, it is likely that a similar scenario will play out going forward.

Returning to the JP Morgan analysis, even if the economy is in a recession today, historical averages would suggest that an additional 2% downside over

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the next twelve months might be expected. The point to realize here is that the bulk of the pain for investors is likely already behind us not ahead of us. If you have a twelve month or more time horizon, chances are very likely that today would be a far better buying opportunity than a time to sell. Panicking now could only compound your problems by causing you to miss tomorrow's springboard.

The lesson for investors, of course, is adequate diversification. The Broadleaf Growth Equity portfolio has declined since the S&P 500 hit its peak in October of 2007, but by roughly half of the S&P 500's decline. While we have been lucky in some areas, we can't help but believe that our broader industry exposure has likely helped us to weather the storm a bit better than most.

Again, we know that bear markets come and go like clockwork almost every three to four years. If you are finding that the current environment is causing you considerable duress, then you should consider making some adjustments, but don't do it now. Wait for a recovery and then schedule an appointment with your financial adviser in six to twelve months to revisit an asset allocation that more closely matches your tolerance for risk.

Experience, they say, is always the best teacher. Until you've been through difficult times, everything is really just academic or ink on paper. It is through the tough times - the ugly days - that you learn a little bit more about yourself, what you value, and who you are as a human being and even as an investor. These discoveries, I believe, are a gift from God, the silver lining that sustains us through all of life's circumstances.

Take care not to miss it.

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