

Market Commentary

Financial markets continue to react negatively to the news related to the credit crisis. Major players within the investment, banking, and insurance groups continue to reel as consumer confidence drops even further. Investment banks such as Merrill Lynch and Lehman Brothers were caught overleveraged to the mortgage back securities market and have been forced into either bankruptcy or sale due to the current liquidity crunch. American International Group, or AIG, a large financial service conglomerate, is now reeling from missteps in the derivative markets and is also being forced to both raise capital and sell assets at “fire sale” prices. All of these events are clearly indicative of both the current financial crisis and its historical proportion given the long history of some of these firms.

During these periods of “panic selling” individual investors are well-served to remind themselves of the importance of not making dramatic overhauls to their portfolios unless absolutely necessary. During periods of crisis, liquidity commands a premium and as a result, trading costs soar. This can be easily seen in the widening of spreads amongst individual stocks. Furthermore, the “flight to quality” places premiums on safe investments such as treasuries and gold, through the rapid ascent of their prices due to high demand. The end result is that investors who liquidate stocks and move to safer investments often experience a “double whammy” during these periods; potential tax consequences can lead to a “triple whammy.”

Clearly, investors are well-served to use these brief but extreme periods of volatility to reassess their tolerance for risk and fluctuations to their portfolios. These crisis periods are not uncommon to stock investors but have occurred several times during the last decade, most recently during the period following the forced sale of Bear Stearns in May of 2008. Other crisis periods such as post September 11th, the 2000-2002 dot-com bust, or even the 1998 crisis caused by Long-Term Capital Management (an overleveraged hedge fund) also exemplify similar periods during which financial markets were in a free fall. Eventually the financial markets were able to work through these periods and produce positive returns. As a result, making dramatic shifts during periods of crisis should often be reserved for only extreme situations. Instead, making these shifts during calmer times should both save money and improve the longer-term returns provided by one’s portfolio.

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