

Is The World Disintegrating?

Iraq, Iran, Korea, Al Qaeda, Oil Prices..Oh My Gosh And now, Hezbollah, Hamas and Israel

Many of you were able to attend the workshop we held exactly one week following the tragic, gut wrenching, and unfathomable event we now commonly refer to as 9/11. We also shared our strongly held views of the future of our financial markets and the world economy following this shocking event. For those who were not able to attend this TWO hour historical recount of the financial markets during times of adversity (“Real” or “Imagined”), we will review a few key points we made at that meeting because we have the same opinions today. Our advice to you and our forecast for the financial markets have subsequently proven to be true. It is important to remind us all that we are not clairvoyant nor do we “see all, no all,” but more to the point, we are ardent students financial and human history which helps provide clarity. To help you recall how disconcerting it was then, don’t forget, this 9/11 catastrophe was approximately one year following the beginning of one of the greatest stock market crashes in nearly one hundred years!! I can’t imagine a more depressing or frightening combination of events when considering our personal financial lives. To add fuel to the fire, if you were within five years of retirement (Pre or Post), you were experiencing real “high anxiety.” Whether the real and intense discomfort many experienced was founded on emotion or logic is not relevant. It was there, it was real to you, it affected you. We know that many of you are again concerned given the turmoil we are witnessing in the world.

Our job as comprehensive wealth managers/financial planners is not what most people envision. Yes we are good with finances, numbers, financial history, etc. But our key role is integrating the real human element – Your personal lives, your feelings, your desires, your biases - with financial REALITY. All of us deal with money issues differently. Money is also a very emotional issue for all of us, regardless of the number of zeros behind our balance sheet. Money is also very personal. Money can be scary for all kinds of reasons...fear of running out of it, losing it, fear of making wrong decisions, etc. Our job as wealth managers is difficult, yet critical as we try to discover your true life goals, evaluate your feelings and comfort level, and assess the likelihood of achieving your desires. We then help you plot a course to steer you towards your destination.

Unfortunately, today we are bombarded with 24/7 news. In today’s world of 24/7 news media outlets are constantly searching for any “news”, and mostly negative “news”, we as humans can’t help but be impacted, regardless of our knowledge of the subject or our logical analysis. Further, in the world of money, we find the “news” is frequently distorted.

An ongoing part of our job is to deploy discipline, analyze dispassionately, and view the daily noise and events in a rational, logical fashion. We always evaluate events in a historical context of the financial markets, the historical politics, the historical human reactions, and what we deem are the “facts” based upon a somewhat predictable and repetitive history.

OK, before we go any further, our bottom line point to this mini-white paper is that we once again believe that “This too shall pass”. The global economy is very strong. The growth investments in your portfolio are long-term; they will always fluctuate as market participants react, often emotionally, to current events. But, our fervent view and belief is that history will once again demonstrate that current the current headlines will not materially change the impact on these investments over the next five to ten years. Our perspective and source for this strong belief is the last 100 years of economic and political history. Actually, you can modify that last statement, because human nature has not changed since the origin of mankind!

We want to share our amateur political analysis of the current events and our professional view of the potential economic and financial impact on your life! You may or may not agree with our view of the current situation in Lebanon, but we hope you understand it does NOT matter. If we put the current events in historical context, just as we did following 9/11, we say to you we are confident life will go on, the economy will go on, the financial markets will go on.

Our first focus is the current “crises”, the terrorist attacks by Hezbollah and Hamas against Israel. We make the statement that this is against Israel for the simple and what we believe factual observation that Israel unilaterally withdrew from the occupied region of Lebanon (That Israel invaded and occupied for their sovereign protection) and ditto for the Gaza strip. What we are currently witnessing is the zealot nature of terrorists. Israel can, and in our view has behaved in a moral fashion...to no avail! For decades, we have felt that the “cold war” was not that scary because we were dealing with nations that felt there was “something to lose.” This is NOT the case with Al Qaeda, Hezbollah, the Taliban, the PLO and Hamas. Arafat rejected the Oslo treaty for the Palestinians and we are watching the response by Hamas and the Hezbollah to Israel's unilateral withdrawals.

It is hard to dispute the facts that Iran co-founded Hezbollah and has provided weapons and training along with Syria. Further, the UN resolution 5059 specifically dictated the disarming of the Hezbollah and their removal from southern Lebanon – It NEVER happened. This is yet another example of the impotence of the UN. Our view is that Israel has every right to defend itself in this matter. The difficulty is that the Hezbollah is indigenous to Lebanon, unlike the Al Qaeda in Afghanistan. The Hezbollah terrorists do not wear uniforms and thus can melt into the local Lebanese society, making a ground invasion by Israel futile. Israel has no choice but to defend itself from TERROISM. Can you imagine if Beirut was only 100 miles from your home or Damascus was only 129 miles away?!

We believe that Syria and Iran are a big part of the problem. Israel is being criticized for an extreme retaliatory attack by bombing much of Lebanon's infrastructure and blockading Lebanon with its navy. Our view is Israel is justified to cut-off the routes for Iran to ship arms to the Hezbollah via highway, sea or airways. It is a fact that Iran has regularly shipped arms through Damascus in front of U.S. Congressmen and has Iranian military advisors on the ground helping the Hezbollah!

We don't know how this will end. Clearly, a “cease fire” does not work well with terrorists. Israel's current strategy seems to be to destroy as much of the Hezbollah as possible from the air. Our best guess a DMZ (Demilitarized Zone) will be established on the Lebanese and Israeli border with an international coalition of troops to enforce it.

Again, we know that some of you may disagree with these views. We accept that. BUT, please keep an open mind as we discuss our analysis of the latest world political upheaval on the economic and financial world.

We believe Iran won't get directly involved because Israel has approximately 300 nuclear weapons. Even though Syria attacked Israel in 1967 and 1973, they supported the U.S. during the 1991 Iraqi war. Further, they are a "paper tiger" militarily. And, much of the Middle East does not support the Hezbollah – Jordan, Egypt, Saudi Arabia. Consequently, we are not concerned about a potential oil embargo. In fact, as we write this piece, oil prices have already declined a few dollars per barrel.

We do not believe the current situation will precipitate a "bear market" (Defined as a decline of 20% or more). In fact, due to the small correction experienced beginning in May this year, according to the Federal Reserves model, the U.S. stock market is a little over 20% undervalued. If we do experience a "Bear Market", history suggests it won't last that long. Since World War II, we have experienced a "Bear Market" every six years with an average decline of 29% and the average length little over one year.¹ The point is that Bear Markets are a fairly normal phenomenon, and historically have been a temporary dip in the onward climb of the stock market. If the market declines further due to the current world turmoil, history suggests it will rebound. Based upon the current economic conditions and the markets valuations, we think stocks are a BUY! We believe a Bear Market is a low probability event.

You may wonder what historical effect national and international events have had on your investments. Do things like elections, wars and disasters cause market instability? History has proved that the market is more powerful than any single event. Though past performance cannot guarantee comparable future results, the stock market has often rebounded following sudden "flight-from-fright" downturns. Many other factors can and do affect the stock market, causing short-term traders to pull their hair out. But prudent investors know that such events may offer great buying opportunities. See the chart below:

¹ Source: Ned Davis Research, period ending 12/31/05. Figures based on Dow Jones® Industrial Average which comprises 30 large (NYSE) stocks. Indexes are unmanaged and include reinvested dividends; one cannot invest directly in an index. For illustration only. **Past performance does not guarantee future results.**

Date	Event	%Drop (Price Only)	Regained Lost Value	Next Market High
10/14/62–10/28/62	Cuban missile crisis	-6.60%	1 week	10 months (9/3/63)
11/22/63	Kennedy assassination	-2.81	2 days	3 weeks (12/17/63)
8/9/74	President Nixon resigns	-15.32	6 months	Nearly 6 years (7/17/80)
11/4/79	American hostages taken in Iran	-2.58	1 week	8 months (7/17/80)
3/30/81	Assassination attempt on President Reagan	-0.27	Next day	19 months (11/3/82)
10/19/87	Stock market crash	-20.47	1 year	9 months (7/26/89)
8/20/90	Iraq invades Kuwait	-13.63	6 months	1 week (2/13/91)
7/1/96	Technology stocks nose-dive	-7.28	7 weeks	Same day (9/13/96)
10/27/97	Asian market meltdown	-6.87	1 week	5 weeks (12/5/97)
8/18/98-8/31/98	The devaluation of the Russian ruble; Russia defaults on billion-dollar debt	-13.07	9 weeks	3 weeks (11/2/98)
1/13/99	The devaluation of the Brazilian real	-1.80	1 day	11 days (1/29/01)

Source: ©2001 TowersData Inc. Past performance cannot guarantee comparable future events. The stock market is represented by the S&P 500 Index, a group of unmanaged securities widely regarded to be representative of the stock market in general; results assume reinvestment of dividends. An investment cannot be made directly in an index. This table is not intended to show any cause and affect relationship between events and market performance.

The power of time can reduce market risk. Historically, since 1926, stock market volatility has decreased as your holding period increased. There have only been 2 ten year holding periods in which positive returns were not achieved in the stock market.

Years (1926–2005)	Unmanaged S&P 500	
	Up	Down
1	54	21
5	64	7
10	64	2
15	61	0

Source: ©2005Ibbotson Year book. Past performance cannot guarantee comparable future events. The stock market is represented by the S&P 500 Index, a group of unmanaged securities widely regarded to be representative of the stock market in general; results assume reinvestment of dividends. An investment cannot be made directly in an index. This table is not intended to show any cause and affect relationship between events and market performance.

In conclusion, we are concerned and saddened about the events in the Middle East as are you. However, we are not concerned about the potential impact upon the economy and our financial lives.

Thank you for your trust and confidence.

Karen Lee, CFP, CLU, ChFC, MSFS, AEP

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