CAPITAL ADVISERS, INC.

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Capital Ideas

"Lions and Tigers and Bears, Oh My!" Dorothy

"So I'm Watchin' and I'm Waitin', Hopin' for the Best; Even Think I'll Go to Praying Every Time I Hear Them Sayin' That There Is No Way To Delay That Trouble Comin' Every Day." Frank Zappa

The *Wizard of Oz* came out in glorious Technicolor in 1939. The world was just beginning to recover from the Great Depression and World War II was just around the corner. There was plenty to be concerned about.

The Mothers of Invention released *Freak Out* in 1966. Frank Zappa had written *Trouble Every Day* in response to the Watts riots. I was not around for the Great Depression—though my kids may think so—but I was around for the Watts and other riots. My Dad was in the National Guard and I recall him spending days in Charleston, SC, trying to help keep order there. That was a scary time.

Today, we find the Republicans losing control in Congress because of the Iraq situation. The housing market appears to be set for collapse. That will cause the economy to enter a recession. The Dow has hit all-time new highs. The S&P 500 just hit a six-year high. The FOMC's (Federal Open Market Committee) comments on the economy have been positive recently. Even former Chairman Greenspan has said that the housing decline may be leveling out. The market will surge or the market will collapse. Who, and what, do you believe?

It feels like we have just recovered from the market collapse of 2000—2003. And, now, we have plenty evidence pointing to a recession. The housing market is vital to the health of the economy. When the stock market failed, many turned to the housing market for investment. Flipping properties, interest-only mortgages, ARMS, ARMS, ARMS. As if people did not learn the lesson of leverage in the tech boom, they repeated the same mistakes in real estate.

So who is right? Will the real problems in the housing market pull us into a recession? Or, are we just beginning another upsurge in the market?

If you know the answer please call me. With the correct future forecast we can make a lot of money.

The truth of the matter is that no one knows when we will have another recession. Notice that I did not say "If". We will have another recession. The only question is when.

Is that so terrible? Recessions are a normal part of the business cycle. The market, despite the best work and intentions of the Federal Reserve Board, is prone to boom and bust cycles. Investors—and that includes real estate investors and home owners who bought too much house or took out their equity—get euphoric when markets rise and severely depressed when markets fall.

That is just way too much drama! But, those cycles of boom and bust are also a useful tool for the smart investor.

The markets, any markets, do not have sympathy for individual investors. The smart people know that you make more money when the markets stink than you do when everything looks great. It does not take a genius to figure out why. When the markets get hot investors start to foam at the mouth like Pavlov's dog. They continue to perform the act that produced the treats long after the treats have been cut off. They keep thinking that the treat will show up if they just continue to do what gave them the reward before.

Brilliant! That is why a sell discipline is so much more important than a buying strategy. That is not to say that you must know the absolute best time to sell —just try not to be too greedy or too stubborn. If a stock has had its price cut in half, you should have already sold it. It is not coming back. At least not anytime soon. And don't try to time the markets. I have never met anyone who could successfully time the market except by back-testing.

We beat our performance bogeys over the last three and five year periods because we did not give everything up when the market went down. We were also positioned to take advantage when the markets began to rise. There were no market-timing calls, just asset allocation. We know that when you start believing your press, the end is near. Investing will humble the strongest and most confident people.

That is why we ask you to take a little risk tolerance test when you come on board. It does not give us any great insight into your psyche. It does not accurately state your risk tolerance level. All it does is force you to give a little thought to the fact that the market does go through recessions. And, when it does, we do not want you to give up. We do not want you to think that we have suddenly become the village idiots, incapable of preventing a loss in your account. Others will try to make you think that, but it will not be true. We will get through with patience. And we know how difficult it is to be patient when your account is decreasing.

So, what we would like for you to do while the market is hitting new highs is to review your risk tolerance. If the market were to fall tomorrow, are you comfortable with your asset allocation? Don't be afraid to talk with your advisor. She can't read your mind.

Remember, we have nothing to fear, but fear itself. Now, was that a quote from Franklin Roosevelt or Vernon Reid (of Living Colour—apparently this was too obscure for my proofreaders)? Just one more thing to ponder.

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