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WEALTH MANAGEMENT & BENEFITS GROUP

2008: The Financial Year in Review

Quote of the year. **"**I find the great thing in this world is not so much where we stand, as in what direction we are moving." – Oliver Wendell Holmes

The year in brief. In a sentence, the story that shaped this year is simply stated: the collapse of the subprime mortgage markets sent the U.S. economy into a severe recession and led to $1 trillion in global credit losses. The fallout was remarkable: the broad stock market (as measured by the S&P 500) had its poorest year since 1931.[1] Wall Street's landscape changed as titan investment banks disappeared or merged. The federal government intervened in the economy in a way it hadn't since the Great Depression, and effectively reduced interest rates to zero.

At the start of 2008, most economists saw a host of problems coming our way: declining home prices and stagnating home sales, increasing energy costs, and tighter credit. Those predictions largely proved true. By the end of 2008, any concerns about inflation had been replaced by concerns about deflation. Even the commodities markets were hurting by the end of a year that hopefully represented an aberration in U.S. economic and financial history.

Domestic economic health. Do you remember Federal Reserve chairman Ben Bernanke's talk of a "Goldilocks" economy? Well, it was a hard landing instead of a soft one. Late in 2008, the National Bureau of Economic Research confirmed that America had been in a recession since December 2007. As figured by NBER, GDP was +0.9% for 1Q 2008, +2.8% for 2Q 2008 and -0.5% for 3Q 2008.[2] Some economists now think 4Q 2008 GDP will fall between -4% and -6%.[3]

Major financial firms faced potential collapse. Some were bailed out by the government (Citigroup, AIG, Fannie Mae, Freddie Mac). Some merged or were bought up (Bear Stearns Co., Washington Mutual, Wachovia, National City Corp.). Others mutated (Morgan Stanley, Goldman Sachs, American Express Corp.), and others just said goodbye (Lehman Bros., IndyMac). The rescues of Fannie Mae, Freddie Mac, AIG, the bankruptcy of Lehman Bros., the Treasury's announced guarantee of money market funds, and Treasury Secretary Henry Paulson's request for a massive bailout plan all happened in a chaotic stretch from September 8-19. Initially rejected in Congress with disastrous results for the stock market, the bailout passed on October 3, resulting in the creation of the Troubled Asset Relief Program (TARP).

TARP was conceived to buy up toxic assets. Instead, it used most of the first half of its $700 billion (roughly equal to the entire economy of the Netherlands) to buy shares in private banks, with virtually no accounting of what the banks were doing with the cash.[4] General Motors, Chrysler and GMAC also received TARP funds. On November 25, the Federal Reserve presented TALF, the Term Asset-Backed Securities Loan Facility, which would buy up to $200

billion in consumer debt securities. On the same day, the Fed signaled it would do what the Treasury sought to do back in September – buy up to $600 billion worth of mortgage-backed assets.[5]

By November, unemployment had reached 6.7%, on the way to 8% or 9% in the eyes of many economists.[6] Jobless claims hit a 26-year high in the week ending December 20.[7] By fall, indicators showed that personal spending, retail sales, industrial output, the service sector and the housing sector were weakening or in more trouble than previously assumed. General Motors, Ford and Chrysler came to Washington D.C. for bridge loans, as auto sales had plunged 35-50% from 2007 levels.[7] There were two bright spots: energy costs fell late in the year, with the price of gasoline retreating to 2004 levels, and Americans' personal savings rate began to increase again.

Major indexes. A decent year on Wall Street was succeeded by an abysmal one. 2008 was definitely exciting: in late summer and fall, the Dow occasionally traded in a 500- to 1,000-point range over the course of a single market day. It was also dismaying: the Dow sank roughly 10% in June and more than 10% in October.[8] But the broad stock market rose more than 20% between the low point of November 20 and the conclusion of 2008.[9] In the end, the Dow and S&P 500 had their worst year since the Great Depression, and the NASDAQ had its worst year ever. Most stock market analysts and economists see a market recovery in the coming quarters.

% Change	2007	2008
DJIA	+6.43	-33.84
NASDAQ	+9.81	-40.54
S&P 500	+3.53	-38.49

Source: CNBC.com, 12/31/08 Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends.

Global economic health. At the start of 2008, the European Central Bank and the central banks of India and China were trying to find ways to control inflation. By the fall, that had changed. Across 2008, the Federal Reserve reduced America's key interest rate from 4.25% to virtually 0%; the ECB reduced rates from 4.0% to 2.5%, the Bank of England from 5.5% to 2.0%, and the People's Bank of China from 7.47% to 5.31%.[10] Assorted governments considered or implemented stimulus packages.

In January, a United Nations report projected a "slight slowdown" in Asian economies in 2008, forecasting 10.8% growth for China and 9.0% for India.[11] But things were revised downward after recessionary forces took effect. By

December, China's factories were letting workers go at the fastest pace ever recorded, and India's manufacturing sector was cutting jobs for the first time since 2005.[12] The World Bank put 2008 GDP for China at 9.4%, with growth at 8.5% for the East Asia and Pacific Region; it put growth in the South Asia region (which includes India) at 6.3% for 2008, down from 8.4% in 2007.[13] In November, the International Monetary Fund put India's 2008 GDP at 7.8%.[14] Japan has been in a recession since 2Q 2008: its economy shrank 0.9% in that quarter, and 0.5% in the third quarter. Morgan Stanley forecasts Japan's 2008 GDP at between 0.0 to -0.2.[15]

The Eurozone entered its first recession last year. Its growth contracted by 0.2% in both 2Q and 3Q 2008.[16] England's GDP contracted by 1% last year, according to estimates.[15] Germany, the EU's most powerful economy, saw GDP of -0.4% in 2Q 2008 and -0.5 in 3Q 2008, positioning it for its worst recession since the mid-1990s.[17]

World financial markets. Of the major stock indices, England's FTSE 100 had the least painful year. It fell 31.3% in 2008. Germany's DAX index sank 40.4%; France's CAC 40 dropped 42.7%; the Dow Jones Stoxx 600 fell 46.0%.[18] Some stock markets had it even worse, such as the ICEX in financially shaken Iceland (down roughly 94%), the benchmark RTS index in Russia (down 72.5%) and the NASDAQ Dubai exchange (down 72.4%).[19, 20]

Back in 2007, the Shanghai Composite Index ascended an astonishing 96.7%. In 2008, it fell 65.4%. Hong Kong's Hang Seng lost 48.3%. India's Sensex sank 52.4%. In South Korea, the Kospi lost 40.7%. The Nikkei 225, which dipped 11.1% in 2007, fell 42.1% last year. Australia's ASX 200 lost 41.3%; New Zealand's NZX-50 lost only 32.8%.[18] Believe it or not, there was an index that gained last year: the Stock Exchange Tunis (Tunisia) rose 10%.[21]

Commodities markets. The second half of 2008 was trying for many commodities investors. Gold still gained: it started the year at $838.00, climbed to a record $1,033.90 and ended 2008 at $883.60 on the New York Mercantile Exchange for a 5.4% annual increase. Silver and copper didn't do as well: copper lost 56.5% and silver 35.6% in 2008.[22]

The bottom fell out of the energy market. Oil futures closed 2008 at $44.60, down 53.5% for the year and nearly 70% below their $147.27 peak on July 11. Gasoline futures settled 2008 at $1.01 per gallon, a 59.2% annual drop. Natural gas futures closed 2008 at $5.622, down 24.9% for 2008.[22]

Ag futures also posted losses for 2008. Wheat fell 31.0%, corn 10.6%, and soybeans 18.3%.[22]

Housing & interest rates. Sellers, agents, brokers, builders, lenders, analysts – they all hoped for some kind of bottom, but as 2008 went on, it didn't happen. As ARMs started to reset and other economic factors pressured homeowners, the toll was evident: by May 2008, foreclosure filings were up 48% from May 2007 totals.[23] The latest year-over-year statistics we have tell the story. November existing home sales were down 10.6% from a year

before; existing home sale prices were down 13.2% from 12 months ago, the biggest year-over-year drop since recordkeeping began in 1968. As for new homes, the November data showed prices down 11.5% and the sales pace down 35.0% from a year earlier.[24]

Mortgage rates provided the silver lining for those who could refinance. At the end of 2008, Bankrate.com's national survey of major lenders had 30-year conventional mortgages at 5.64%, compared to 6.14% at the end of 2007. The Bankrate index had 15-year FRMs ending 2008 averaging 5.16% and 5-year ARMs averaging 5.86%.[25]

2009 outlook. So when will the economy get better? And when will the stock market turn around? The answer to the first question, in the eyes of many economists, is "late 2009 or early 2010". The answer to the second question could be the same as the first … but the health of the stock market does not necessarily mirror the health of the overall economy. Historically, market upturns have often coincided or preceded the close of recessions. Some analysts believe the fourth quarter of 2008 will turn out to be the economic low point of this current recession.

At this point, as many eyes are on Washington D.C. as Wall Street. Our new President's economic stimulus plan emphasizes long-term infrastructure and job creation projects rather than boosting consumer spending. Currently, consumer spending is weak and poised to get weaker given that unemployment and foreclosure rates will almost certainly rise during the year. So the big question is whether Wall Street can keep its chin up and withstand the next couple of quarters (along with the American consumer) while the new stimulus rolls out. Of course, aid could also come in the form of the Federal Reserve buying up toxic securities and thawing the consumer credit market. In the eyes of many analysts, the new administration must drive the recovery.

So will 2009 be positive or negative for stocks? The pessimist may point to 2000-2002, when the DJIA suffered three consecutive years of losses, or the mid-1970s. The optimist might look back decades earlier and cite what happened after the double-digit market drop in 1933: the DJIA posted gains of 25% or more for five of the next six years.[1] Most economists feel 2009 will be a transitional year, in which we climb out of a recession toward better times and better markets. Those who stay invested stand a real chance of being rewarded as the economy and Wall Street improve.

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The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. It is not possible to invest directly in an index. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx®, and the Pacific Exchange). NYSE Group is a leading provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. (NYMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals, with trading conducted through two divisions – the NYMEX Division, home to the energy, platinum, and palladium markets, and the COMEX Division, on which all other metals trade. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The Dow Jones STOXX 600 Index is a subset of the Dow Jones STOXX Global 1800 Index and represents large, mid and small capitalization companies across 18 countries of the European region. The OMX ICEX 15 Index is a free float adjusted market capitalization weighted index of the 15 largest and most traded Icelandic companies of the OMX Stock Exchange. The RTS Index (RTSI) is an index of 50 Russian stocks that trade on the RTS Stock Exchange in Moscow. NASDAQ Dubai (formerly called the Dubai International Financial Exchange or DIFX) is the international stock exchange between Western Europe and East Asia. The Shanghai Stock Exchange Composite Index is a capitalization-weighted index that tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange. The Hang Seng Index is a free-float capitalization-weighted index of selection of companies from the Stock Exchange of Hong Kong. The Bombay Stock Exchange Sensitive Index (Sensex) is a cap-weighted index of 30 stocks; selection of the index members has been made on the basis of liquidity, depth, and floating-stock-adjustment depth and industry representation. The KOSPI Index is a capitalization-weighted index of all common shares on the Korean Stock Exchanges. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The S&P/ASX 200 measures the performance of the 200 largest index-eligible stocks listed on the ASX by float-adjusted market capitalization; it is widely considered Australia's preeminent benchmark index. The New Zealand Exchange Limited 50 Free Float Total Return Index is a modified market capitalization weighted index of the top 50 companies by free float adjusted market capitalization that are listed on the New Zealand Exchange Limited. The Stock Exchange Tunis is responsible for management, the safety and the promotion of the Tunisian market of the transferable securities. These views are those of Peter Montoya Inc., and not the presenting Representative or the Representative's Broker/Dealer, and should not be construed as investment advice. All information is believed to be from reliable sources; however we make no representation as to its completeness or accuracy. All economic and performance is historical and not indicative of future results. The market indices discussed are unmanaged. Investors cannot invest in unmanaged indices. Please consult your Financial Advisor for further information. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards.

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