

Riding Through Global Volatility

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In May, stock markets around the world dropped approximately 10% to 15% from their highs in late April. Much of the current anxiety surrounding the global markets centers around Europe. Many contend the debt problems of a few relatively tiny countries in terms of global GDPs, including Portugal, Ireland, Greece, and Spain will disrupt the general European economic recovery. Their argument – notably that the questionable viability of a handful of small European economies will facilitate a global collapse, or, at minimum, impede a collective economic recovery – requires a huge leap of logic and makes little sense to us.

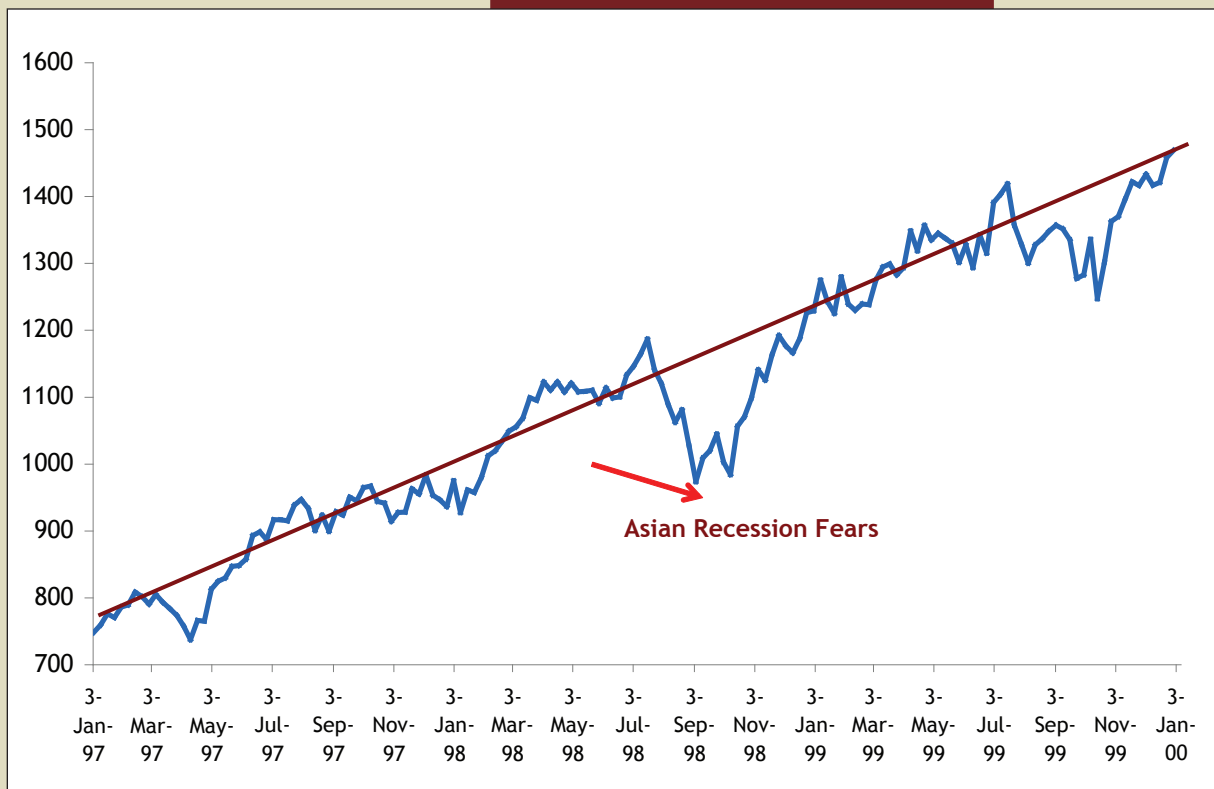
But we have been here at least once before – and investors' worst fears never materialized.

In 1998, economies in Asia were slow and fears grew that a recession in Asia would spread to Europe and then to the U.S. That argument gathered strength and was subsequently em-

braced by investors. Over a six-week period – from July 17, 1998 through August 31, 1998 – the S&P 500 Index dropped 19.3%. Investors must have eaten some bad sushi, because their worst fears were never realized and the market snapped back. As seen in the graph below, the “Asian Contagion” fear (so labeled by the media) was unwarranted, but it was nonetheless so real to investors that stocks took a misguided detour.

The graph suggests that as investor fear over Asia abated, and as investors recognized their concerns over a global recession were misplaced, the market resumed its regular path. We believe the events of 1998 provide us with important lessons for handling the market today. The argument for international economic contagion is just as powerful today as it was in 1998, and, in our opinion, just as wrong. We believe the U.S. economy is too big to be severely influenced by any single overseas event. Our economy has momentum based on the extremely rapid growth in the money supply and the 5.6% GDP burst in Q-4 2009. It's on its own, pre-determined path.

S&P 1500 INDEX (1997 - 1999)



Past performance does not guarantee future results. Source: Bloomberg

A May 27, 2010 survey of economists on Bloomberg reveals no downward revision for U.S. or Euro block GDP as a result of recent events. The Euro outlook is about the same as predicted back in December 2009, while the U.S. GDP outlook has been revised upward since December. Investors are reacting, but economists are not.

When stock prices are driven by investor fears market moves can be unpredictable. We believe it is best to ride through the short-term gyrations as long as stocks are priced below

our estimate of intrinsic value. In 1998, the sharp decline lasted six weeks and then bounced another few weeks before rebounding and resuming its previous path. This time the market has dropped for about five weeks. We think the market is reacting to fears that will eventually be proven wrong despite their powerful appeal. While the market's path over the next few weeks is unpredictable, in time we expect the market advance of the last 14 months to resume. For the time being, it appears the market has eaten a bad batch of baklava and Irish stew. ☺

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Gross Domestic Product (GDP) is the total value of goods and services produced in the national economy in a given year. It is the primary indicator of economic growth.

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