ALVERY BARTLETT GROUP

MARKET COMMENTARY

BY ALVERY A. BARTLETT JR.
November 25, 2008

Investing is serious business and fraught with uncertainty. Every investment carries with it some measure of risk and reward. In this volatile and uncharted environment it is difficult for investors to know if their potential reward is proper compensation for their current risk. The direction of the moves is problematic; the magnitude has been nerve bending. We labor and fret over the writing of these market commentaries. The letters take hours of preparation and drain emotional energy, but represent our attempt to make a positive contribution to your investing effort. Given the circumstances, we feel it is necessary to share our thoughts.

Prices as of November 25, 2008 Close	
30 Year Treasury Bonds (CBT)	126-29/32 3.62% Yield
Dow Jones Industrial Average	8479.47
S&P 500 Index	857.39
Dec. Crude Oil Futures	$50.77
Dec. Natural Gas Futures	$6.88
Dec. Gold Futures	$818.50

I. No Longer Overtly Bearish

The S&P 500 Index market low of 839 on October 10th, 2008 could be considered an internal or momentum low based on: 1) the high downside volume, 2) the overwhelming number of shares traded down versus those traded up, and 3) the coinciding crashes of other indexes across the globe. There had been several prior mini capitulations but the market action of that day could qualify as textbook perfect. In the interim, there have been multiple tests of that low. Most US markets have gone lower, but declined on lower volume. When one observes the movements of all the world indexes, there has been little downside follow through. So far this lack of convincing downside confirmation by other world indexes is worth note, especially given the rash negative news and overwhelming pessimism expressed by virtually everyone with an opinion. Based on these behavioral considerations one could claim that this market might be in the process of bottoming.

The financial carnage, especially in the bond and equity markets, is well publicized, but even more shocking when looked at in linear chart form. The primary US equity markets have dropped approximately 50 percent, but most startling is the 60 percent drop in the most widely held stocks. Based on this downturn, price/earnings ratios have declined and dividend yields on equities have increased. Conversely, corporate bond yields, in many cases, have finally risen to more attractive levels.

Based on these facts, we are no longer as overtly bearish as we have been since early 2007 (please refer to our market letter dated March 28, 2007 at www.alveryb.com). On a longer term basis, we have been generally unenthusiastic about the stock market since 1997-1998 and will probably remain so through 2016 +/-. That does not however preclude the expectation for at least two more rallies of note within this secular bear market.

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II. Not Yet A Bull, But Maybe Should Be

The S&P 500 Index and the Dow Jones Industrial Average have dropped about 50 percent off their 2007 tops and have retraced approximately 55 percent of their gains from 1982. It would seem that much of the negative economic news to follow has already been built into the equity prices. So why are we not yet bulls? Even with this obvious pessimism, there are still many investors who want to buy the market on any dip. Important market bottoms are usually made when investors are eager to sell at any cost and are generally not interested in buying for any reason. Yes, the current market sentiment is negative, but is it negative enough?

We are still not entirely comfortable with the bullish interpretation of value. One measure of market value is dividend yield. The current dividend return on the S&P 500 Index is approximately 3.63 percent. Assuming many dividends will in fact be cut, the realistic current yield is probably closer to 2.8 percent. In previous market lows of significance, going back to 1907, the S&P 500 Index dividend yield has typically been in the 5-6 percent range. An argument can be made that in the past when dividend returns reached the 5-6 percent level, interest rates were 15 percent (as in 1980) not the 2 percent of today or that unemployment was 25 percent (as in 1932) not the projected 8-10 percent of today. These arguments are valid, but what if we are experiencing the beginning of another glacial valuation shift in the way stocks are priced, especially as they are related to bonds. In decades past, stocks were expected to yield more than bonds. Corporations are issuing so much debt and preferred shares, one has to wonder if the debt holders won't end up owning these companies, shutting out the equity holder. Maybe the market has to spend the next five years declining so dividend yields get to 5-6 percent? Perhaps in 2013-2016 we could see the S&P 500 Index's dividend yield approaching 5-6 percent and corporate bonds end up yielding the same or even less.

Following several of the 25 year cycle lows, equity markets lost generations of investors (refer to our market letter dated Sept. 5, 2007). It is true that after having just experienced the worst stock market since 1931, many generations have lost money. What is less clear is whether the current markets stand to lose new generations of investors.

III. At The 60 Yard Line Of A Depression – Of Sorts

There is a view that the world economy is beginning a long and strenuous period of decline. In this view, the 1929 high and the 2007 high are considered one in the same and the global economy is at the beginning of a depression. We are not inclined to agree with that position and pray that we are correct. In our opinion, those holding this particular depression view do not properly account for the spectacular decline of equities from 2000-2002. We would argue that the US has been in a latent economic slowdown of sorts since 1998-2000. Call it a modern day version of the depressionary period that existed from 1929 to 1942. Before we lose you to a statistical argument, we urge you to review the enclosed charts (see DJIA 1929-1942 and NDX 2000-2013).

A picture is worth a thousand words and we suggest you hold the two charts together up to a light, lining up the arrows. In the early 1900's the Dow Jones Industrial Average was considered to be a growth index much like the NASDAQ 100 of today (in the 1930s the Dow Jones Rails Average was thought to be more like the Dow Jones Industrial Average of today). History never quite repeats itself in the exact same way but we are, for this comparison, treating the 1929-1942 chart as an analog for how the markets might behave going into 2013. To explain the chart comparisons, the Dow Jones drop from 1929 to 1932 and the drop of the NASDAQ 100 Index from 2000-2002 were amazingly similar in degree and duration. It is also obvious that the Dow Jones rally from 1932 to 1937 and the NASDAQ 100 rally from 2002 to 2007 were also very close in

degree and length. To date, the NASDAQ 100 has dropped in concert based on what one would expect by observing the drop from the high in early 1937 to the low in 1938. Extrapolating forward, the chart from yesteryear would suggest three things: 1) we should be very close to an important low, 2) we should expect a stout rally into the first half of 2009, and 3) the rally could be followed by a long period of sideways to declining price movements from 2010-2013 (as it was from mid-1939 to 1942). This range bound market would hold only marginal promise on a risk-reward basis. At the moment, this also fits our longer term fundamental view of the US market and economy.

If we are correct in this analysis (as only time will tell) it could partially explain why: 1) the Federal Reserve thought it had to keep rates so low for so long, 2) fiscal policy was so loose even under what was supposed to be a conservative administration, 3) wage inflation was contained even with very high employment, and 4) stock returns have been so pathetic, given the steady improvement of earnings. Based on this analysis, we believe that the bearish view which anchors 2007 to 1929 could be misplaced. Comparing 1929 with 2000 most clearly describes our current and favored long term view. This is essentially no different from the formal opinion we have held since 2001 (refer to our Jan 31, 2001 market commentary letter entitled Secular Trends of the Next 16-18 Years).

IV. Government Response

As government strives to limit risk, it inevitably mutes the possibility for gain. We are not at all convinced that the government interference in the marketplace will inure to our benefit. Government was also very proactive in the 1930s. Some would argue that government meddling prolonged the economic adjustment and that it was the start of World War II that got the US out of the depression era, not the government work programs. We are certain that some government actions in the 1930s did help ameliorate economic pain, just as some might today, however we remain skeptical about the rescue powers of government and fear long-term repercussions. As we all know, history books are written by the victors. The raging battle between the Austrian School of Economics and its proponents, Ludwig von Mises and Friedrich Hayek, was lost in the 1930s to the Keynesian School of economic thought. Regarding economic matters, most universities have spent the past seventy years promoting an interventionist way of thinking, which has been readily accepted by our political leaders and respected thinkers. We have reason to believe that if government behaves in the same manner as it did post-1932, the results will be similar. Therefore, at this moment, we are anticipating a stout rally from whatever low is made this year to be followed by an extended period of economic lethargy, and stock market behavior similar to the Dow Jones from 1938-1942.

V. So, Do We Buy Now Or Don't We?

Given that we do not believe the stock market will be of any particular great interest, until after 2010, or even 2013 and that the secular bear cycle could last into 2016-2018, we are in no hurry to accumulate stocks unless the price is particularly appealing. On a relative basis, there is no doubt prices are very cheap. On a valuation, technical, and market sentiment basis, we feel the market may have lower to go. It scares the heck out of us, but we think we would like to see a full-fledged, "take-your-breath-away", "get-me-out-and-don't-ever-call-me-again" capitulation before we step in to buy.

As we discussed in our letter dated November 14, 2008, a test of the exchange limits would be appropriate. A 62 percent drop off the highs, a serious test of the 2002 lows, and a break down from this recent base would certainly set the emotional stage for an upside reversal.

Will we get the clarity of such a "never forget" capitulation? We don't know. More importantly if we do get such a move, is buying the break a wise investment? Since we have not been friendly to stocks for so many years, is our opinion jaded to the point that clients are being poorly served by our reluctance to recommend equity purchases? Are we going to miss a wonderful and historic buying opportunity? This litany of questions beg a restatement from our opening paragraph. This is serious business and fraught with risk - risk of buying and risk of doing nothing.

VI. In conclusion,

1. Most likely, we are not heading into an equity depression, but rather we are experiencing the tag end of a depression of sorts that we have been in for nine years, one that could continue through 2013.
2. The equity markets may not have made their near term lows and if the markets experience another short decline to test these lows, we would recommend purchasing stock for a meaningful bounce.
3. Assuming a meaningful bounce occurs, and our fundamental analysis remain unchanged, we are likely to recommend selling into that rally. We would be sellers because we anticipate that the equity markets will be range bound through 2013 and likely to hold only marginal promise, especially on a risk-reward basis.

VII. Our Next Letter

a. In our next letter, we will deal in depth with our continuing interest in natural gas and unlisted REITs (real estate, timber, and structured notes). We plan to discuss our long standing bias toward investing in gold and gold stocks. We continue to believe that with the possible exception of gold, investing for both dividend yield and growth will be as important for the next ten years as it has been since 2000. Investing for growth alone is likely to be a frustrating strategy.

VIII. Your response to these market commentaries would be appreciated.

Sincerely,

Alvery Bartlett Group

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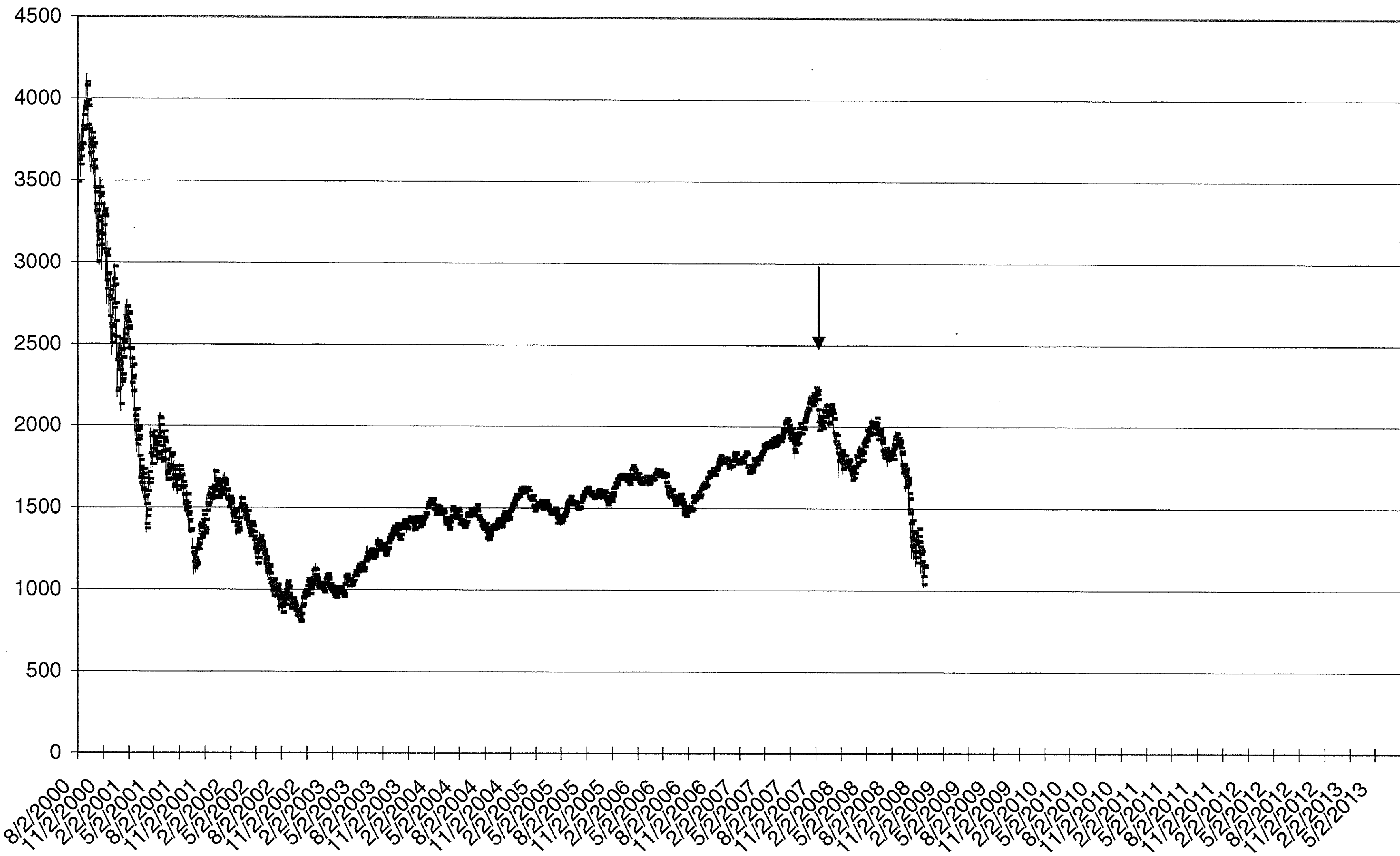
11/26/2008 Current NDX From 2000-----2013
4500
4000
3500
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2500
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8/2/2000
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5/2/2001
8/2/2001
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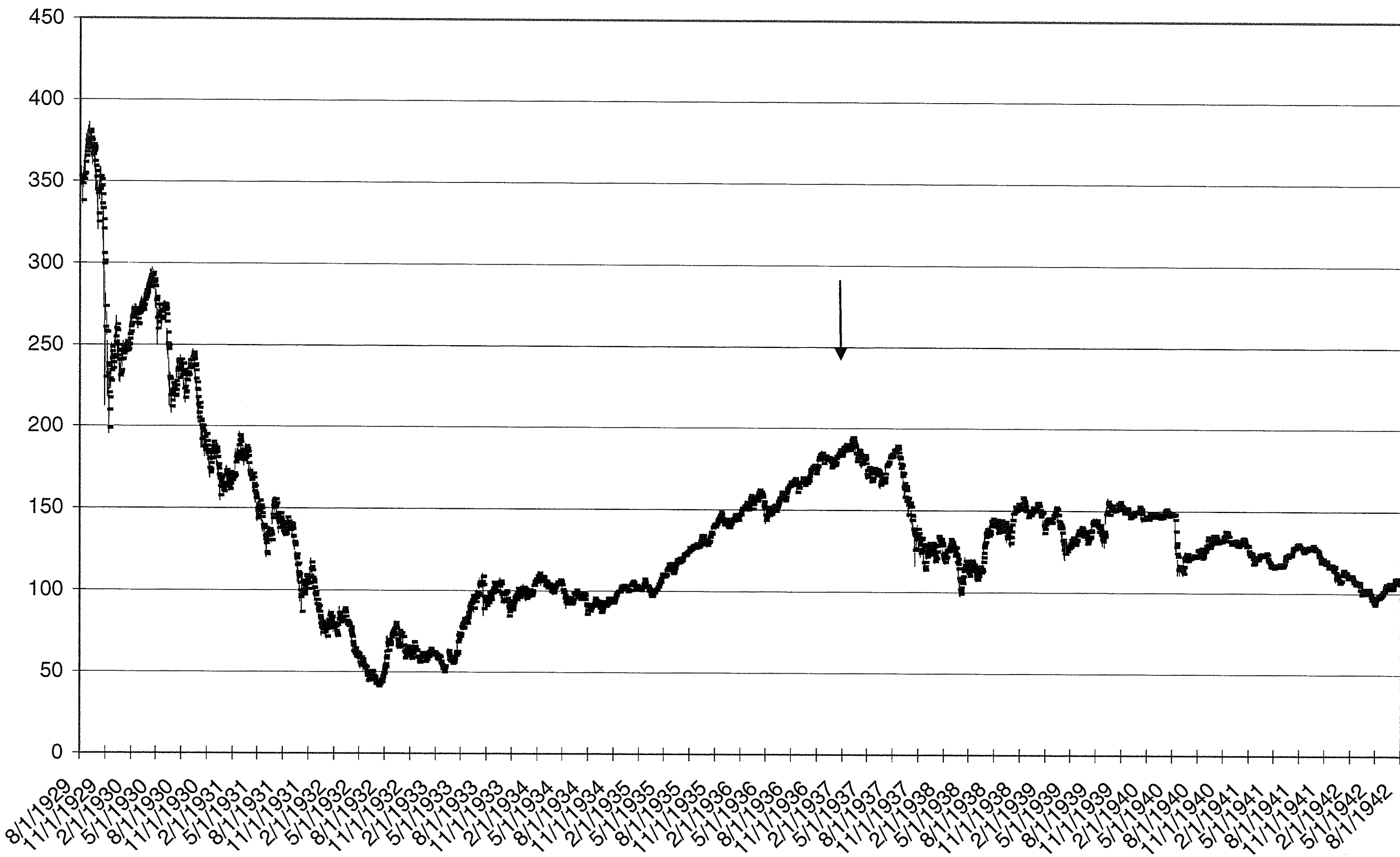
DJIA 1929-1942
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