

# HWM ViewPoint



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April 15, 2009

## Two Perspectives on the Current Recession



On December 1, 2008, the USA was officially pronounced to be in a recession... in arrears! The start date of this declared recession was Dec. 2007.

The **National Bureau of Economic Research** (NBER), is the organization responsible for declaring the starting date and end point of any recession. Thus, the preceding expansion that began in Nov. 2001 and peaked in Dec. 2007, lasting slightly more than 6 years, has given way to this present, fearful contraction.

**Contractions and expansions are a normal and natural part of any economy!** The chart shown on page 2 will demonstrate this. While the challenges presented and subsequent opportunities afforded may change, the on-going cycle continues.

Our clients, mostly with Pittsburgh roots, did not need official word from NBER to surmise that we were in a recession. By mid-2008, our Steelers / Myron Cope "**Terrible Towels**" took on a new role, serving also as "**Crying Towels**" as portfolio values swirled downward!

The all important question for now however, is "**When will this current recession end?**"

It is our opinion that 2009 will be played out as the "**Tale of Two Perspectives.**"

We perceive that Investors will continue to absorb a constant flow of negative news and forecasts this year. This is nothing new. Consider the conversion of author and frequent investment speaker, Harry Dent.

In his 2004 book, "**The Next Great Bubble Boom: How to Profit from the Greatest Boom in History: 2005-2009**", the super-optimistic Mr. Dent prognosticated the Dow at 40,000 by 2009! Unless we have meteoric gains the balance of this year, (*the Dow closed at 8,083 on Apr. 10*) Mr. Dent will be proven wrong. Recently he reversed his outlook to super-pessimism, predicting the Dow at 3,800 within the next 3 years. (Source: Forbes, CBS.MarketWatch.com)

**We believe another perspective is needful.** Historically, it is at the peak of pessimism that financial markets have experience a trajectory out of recessionary periods. We believe this to be the case for the second half of the year. The impetus for stock improvements normally lies in the belief economic improvements are in sight. A chart summarizing **leading and lagging economic indicators** will be shown on page three.

Typically stock market declines precede economic woes, yet conversely, "*woe is me*" eventually gives way to swift market upturns that help to pull the economy from the depths into the next phase of expansion.

So why all the negativity? Have you noticed that many a true headline gets exacerbated and

fails to accurately paint the full picture? As such, often we are not told, as Paul Harvey immortalized, "**the rest of the story!**"

Consider this from April 1, 2009;

**USA TODAY.com**

### **Stocks Post Losses for Sixth Quarter in a Row**

This headline is true. The all-time peak of the S&P 500 was 1565, achieved on Oct. 10, 2007. It closed out on Mar. 31, 2009 at 798, for a **49% decline over the last six quarters!**

HOWEVER, the rest of the story is that for the **month of Mar. 2009, the S&P 500 gained 8.5%!** While the 1st Qt. of 2009 was still down 11%, March represented the **best monthly performance since October 2002**, when the S&P 500 gained 8.8%. (source: USA Today)

Therefore, the April 1 headline could just as easily have read;

### **Monthly Stock Gains in March Best Since October, 1992**

I am also not suggesting that Mar. 2009 was the beginning of the end of the recession. It easily could be another "**Bear Trap**", a mini rally in the midst of a continued bear market.

Let's continue by first looking at historical **contractions and expansions**. It will remind us that all past negative headlines eventually turned positive.

## Stock Market Contractions and Expansions

Symmetry Partners has created the following chart, **Stock Market Contractions and Expansions**. While only covering the period **1973 to 2006**, this time segment clearly shows cyclical truths - there is a normal and natural market cycle! As such, we should not allow current negative perception to alter our long-term investment allocations.

The stock market (S&P 500 below) has

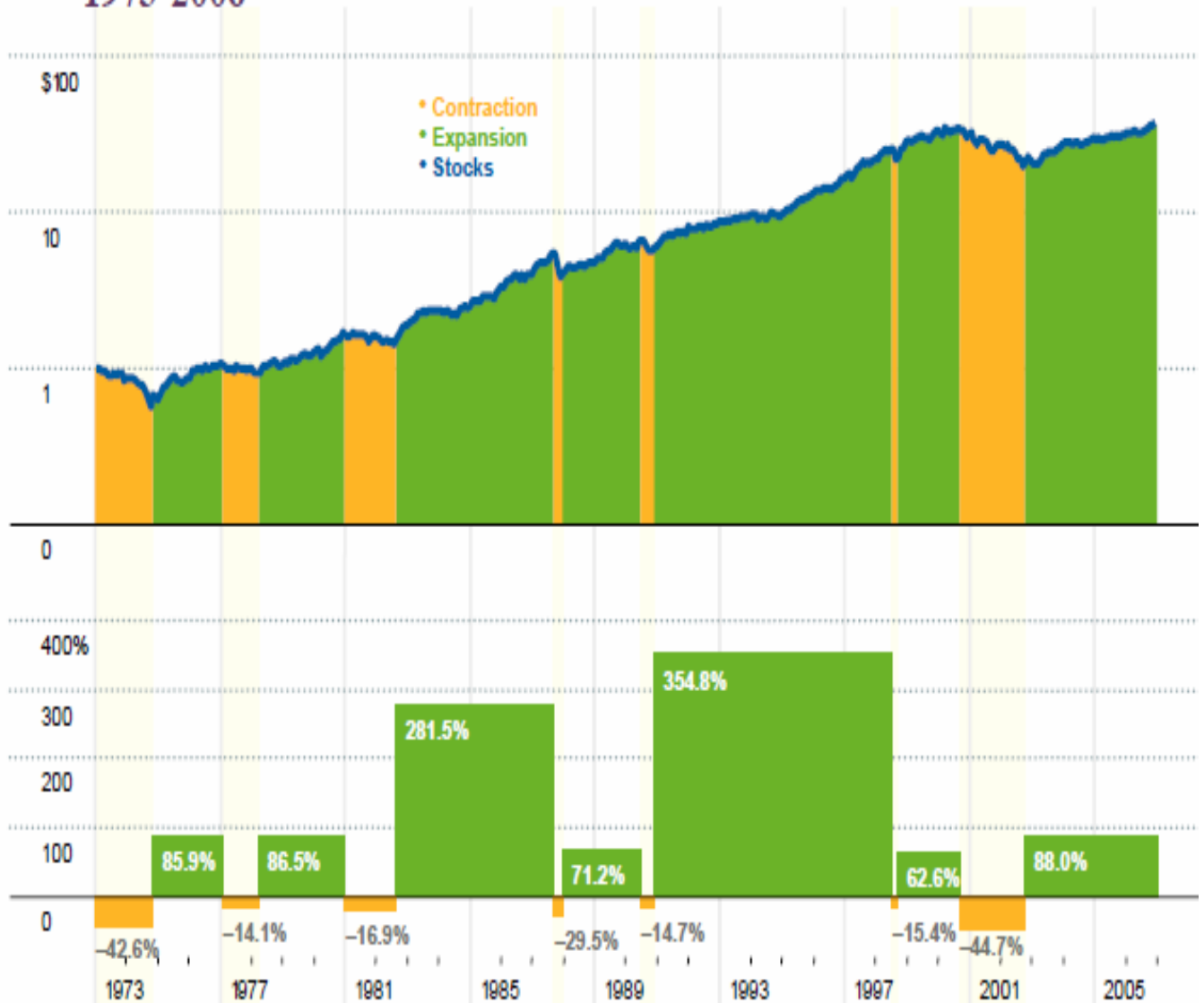
experienced seven “**yellow**” contractions during this 33 year period. The durations varied in lengths; two of them exceeded declines of 40%, as would have the current recession if shown. Contractions are defined by at least a 10% decline from the previous peak.

More importantly however, is that each contraction is followed by a “**green**” expansion, usually longer in length and

higher in gain. For the past 18 months we’ve been heading down the **yellow** brick road. We are hopeful that like springtime, **green** is again upon us. Months from now when looking back, we may conclude that Mar. 2009 was the turning point!

This chart below is also a great segue into our next point on page three; **“What is the State of the U.S. Economy (and where do indicators point)?”**

## Stock Market Contractions and Expansions 1973-2006



## What is the State of the U.S. Economy?



Let's consider the current state of our U.S. economy as of Mar. 2009, by a review what are referred to as the **Leading and Lagging Indicators**. In doing so, we look for emerging patterns that might suggest forthcoming better news for our financial markets and economy.

Russell Investments, a leading asset management provider, compiles a listing of indicators to an assessment tool. When the top three "Leaders" are moving towards their typical ranges, it suggests that the economy may slowly be improving.

As in the case below with current data as of Mar. 31, 2009, two of the three **leading indicators** are moving in the right direction!

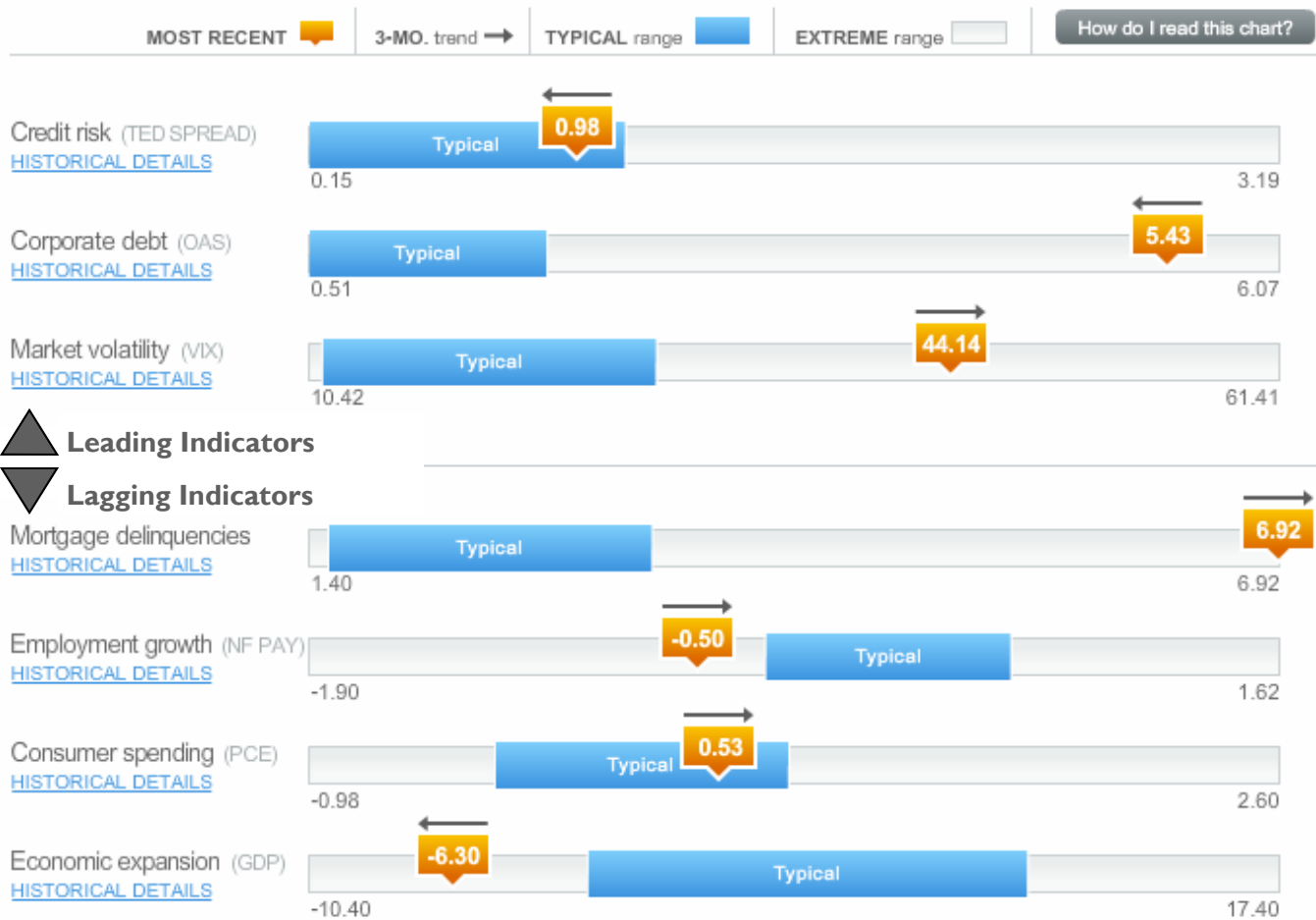
The bottom four **lagging indicators** often follow the trend of the leaders by a number of months or quarters. The importance of laggards lies in their

ability to confirm an occurring pattern. As of Mar. 31, two of four are trending in the right direction.

Contrary to prevailing thought, often shaped by headlines and sensationalized stories, who would have thought that presently, two key leaders and two laggards were actually improving?

Anyone wishing to delve into this Russell Investments chart more deeply may do by visiting:

<http://www.russell.com/Helping-Advisors/Markets/EconomicRecoveryDashboard.asp>.



## The Security of Your Accounts, Part II

Days after the Bernard Madoff scandal broke in Dec. 2008, we wrote “**The Security of your Accounts**” in our Dec. Newsletter. Since that mind-blowing Ponzi scheme was unveiled, others have also surfaced.

As you know, we believe in and practice strategic asset allocation and global diversification. This style has certainly taken its lumps. **Yet we at least hope and sincerely desire that our clients trust us!** We want to be viewed as trustworthy in the sense that not only are your assets allocated in accordance with your long-term goals, but that they are also secure!

As an advance on our previous article, allow me to expand on four key points:

### 1- Do the advisors at Henry Wealth Management use independent third party custodians?

**YES.** Independent third party custodians maintain account records and safeguard assets. They ensure that an unrelated institution maintains physical custody of your assets and maintains account records. **The lack of a third party custodian was the most blatant omission in the Madoff case.**

No one has ever made a check payable to Henry Wealth Management. We simply process deposits made payable to third party custodians, such as **Trust Company of America, NFP Securities, Inc., and Capital Guardian Trust Company** to name a few. Other insurance-based or annuity products are payable directly to the issuing Insurance Company.

### 2- Can you access your account at any time and obtain up-to-date info?

**YES.** Our clients are given 24/7 direct access to the websites of the independent custodians. They may also utilize our **HWM PartnerView** system, which pulls data from custodians' sites into a single, centralized location.

Mr. Madoff was the former non-executive chairman of the NASDAQ stock exchange, an organization with super-sophisticated technology. Yet astoundingly, for clients of Bernard L. Madoff Investment Securities LLC, on-line account access was not available!

### 3- Are quarterly statements mailed directly from independent third party custodians?

**YES.** For our clients that do not have access or a desire to use the internet, we print and mail to them each quarter, **HWM PartnerView** reports. These reports are in addition to, not in place of, mailed statements from custodians.

### 4- Are there restrictions on withdrawals from your accounts?

**NO.** All of your investments may be readily liquidated. While some products are subject to surrender charges for a period of years and certain withdrawals may trigger taxation, your investments are nonetheless liquid!

It is our earnest hope that we are viewed as trusted advisors by our clients and certainly want to provide tangible, verifiable evidence for this trust.



## Avoiding Bear Market Mistakes

Last but not least, we turn our attention to information intended to help us “**Avoid Bear Market Mistakes**”. The next two pages include helpful charts, courtesy of The American Funds, which I will offer a prelude to here.

**Chart 1** explains what is known as the “**Herd Mentality**”. This is the tendency of investors to follow the masses, add-



ing dollars to their portfolios when stocks are rising, and of course, withdrawals when stocks are falling.

Herd members succumb to the “**Emotional Roller Coaster**”, a concept that we have visually shown in previous editions. They tend to **BUY HIGH (based on greed)** and **SELL LOW (based on fear)**. It is my belief that this category is primarily comprised of investors that do not utilize a financial advisor and/or do not invest according to a long term plan.

**Chart 2** examines the behavior of three hypothetical investors from 2000 to 2007. **Investor ONE** buys at the market high in Q1, 2000, gets nervous and sells near the bottom in Q3, 2002, then feeling better, buys again in Q1, 2004. Check out his ending value,

based on a \$10,000 original deposit.

**Investor TWO** buys at the market high in Q1, 2000, intending to hold for the long-term. While his “timing” may not have been optimal, he stays the course and fares far better than Investor ONE.

**Investor THREE** embarks on a long-term strategy known as dollar-cost-averaging, which is to systematically invest each month. Many of you utilize this technique within your 401k's and 529 Plans. Notice his results!

While these are hypothetical examples, they still drive home the importance of deciding on a long-term strategy, whether lump-sum, dollar-cost-averaging or a combination approach, and **STICKING WITH IT!**

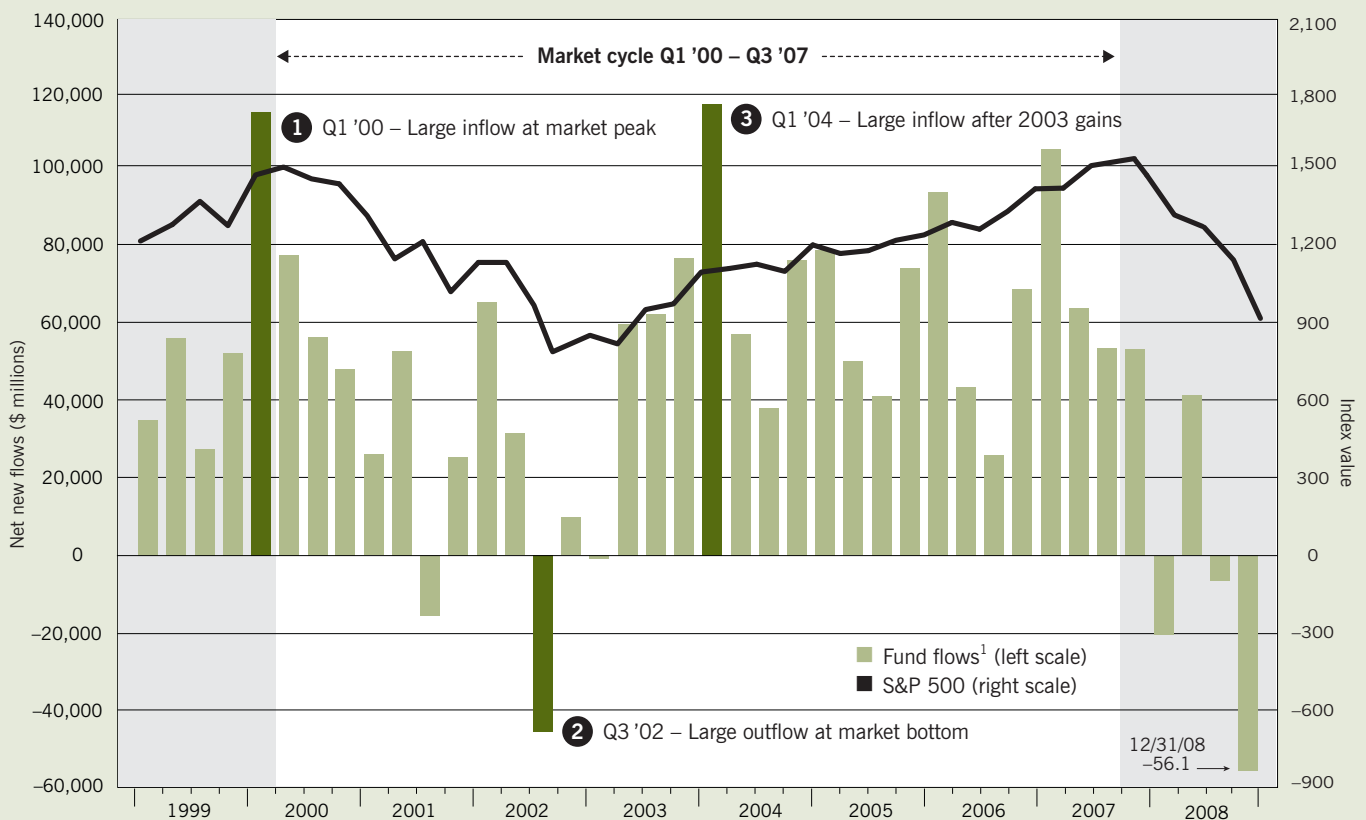
# Avoiding bear market mistakes

There's little doubt about it — when financial markets are on the rise, the desire to invest grows. And when markets decline, investors tend to do nothing or, worse, run for cover. These tendencies were evident during the 10-year period depicted in Chart 1. The black line shows the value of Standard & Poor's 500 Composite Index, and the bars represent the amount of money flowing into domestic and international equity mutual funds and exchange-traded funds. One of the greatest flows of money into the market occurred right as it was peaking in early 2000 — arguably the worst time to invest. Some of the highest flows out of these funds happened when the market hit bottom in the fall of 2002 and 2008. The lesson: By letting market results drive investment behavior, investors risk buying high and selling low.

**Chart 1**

## Buying high, selling low — herd behavior during a market cycle

During the past 10 years, quarterly fund flows closely tracked the highs and lows of the market



<sup>1</sup> Domestic and international equity mutual funds and ETFs.

Source: Strategic Insight. The S&P 500 Index is unmanaged, and its results assume reinvested distributions but do not reflect sales charges, commissions or expenses.

**Past results are not predictive of results in future periods. Investments are not FDIC-insured, nor are they deposits of or guaranteed by a bank or any other entity, so you may lose money.**

### Making good decisions during market declines

When the markets are in turmoil, it's only human for investors confronted with uncertainty to consider changing their investment plan. Some might want to get out of the market altogether. Others may choose to stay the course. Investors with a consistent investment program might wonder whether to stick with their plan.

Chart 2 depicts the behavior of three hypothetical investors during the market cycle from 2000 to 2007. The first (Investor A) represents an investor who followed the crowd, buying high and selling low based on fund flows shown in Chart 1. The second (Investor B) used the buy-and-hold approach, while the third (Investor C) maintained a consistent investment discipline, contributing the same amount per month through good times and bad. The results speak to the wisdom of a slow and

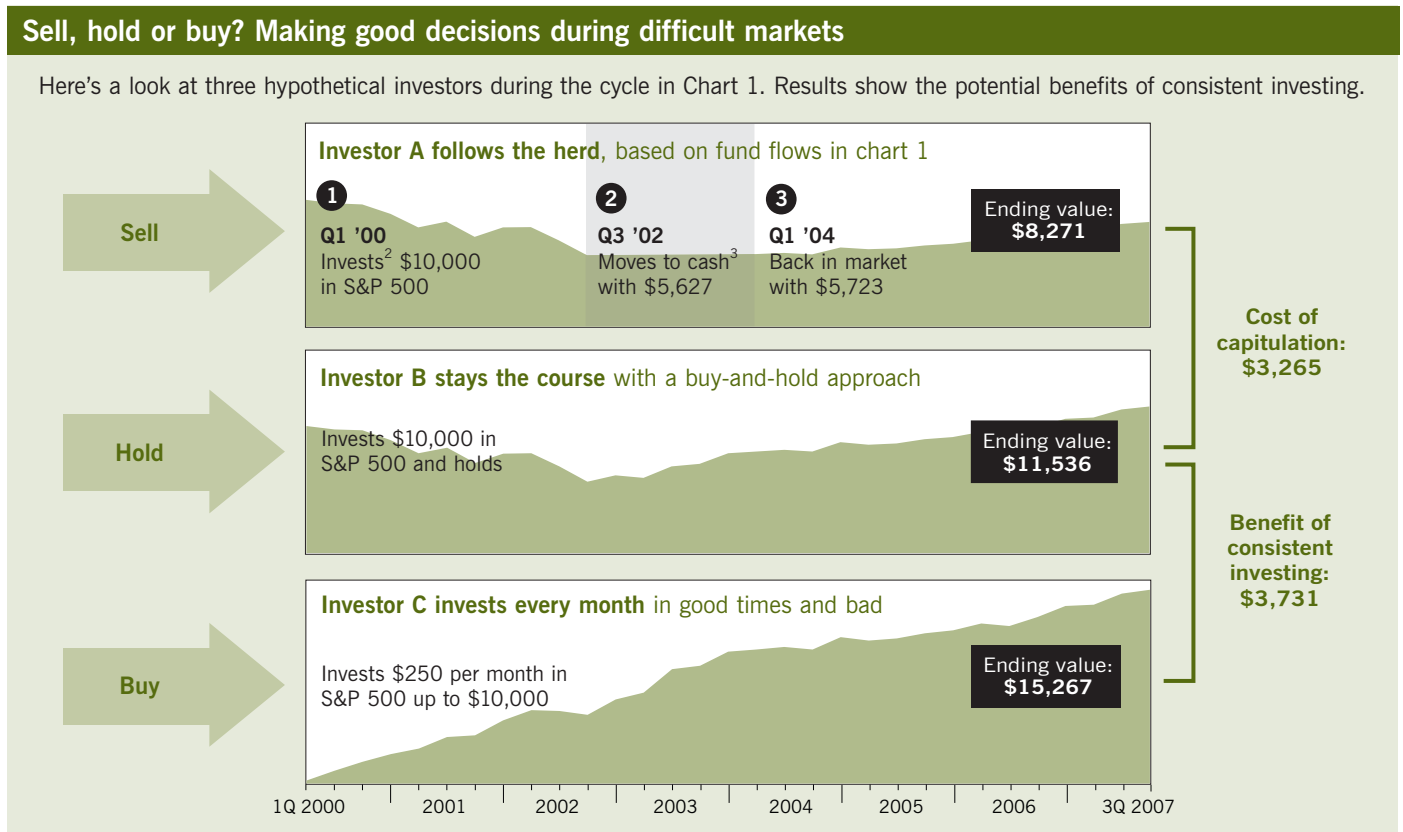
steady investment plan. Investor C's plan resulted in \$6,996 more in value than the investor who allowed the crowd to dictate investment decisions, and \$3,731 more than Investor B, who simply stayed the course.

#### Take action

During difficult markets, investors need a plan. Work with your adviser to develop a systematic investment program that can help:

- Take the emotion out of investing
- Reduce the temptation to buy high and sell low
- Deliver results with the potential to help you reach your long-term objectives

### Chart 2



<sup>2</sup> Investments made at quarter end.

<sup>3</sup> Cash is Citigroup 3-month T-Bill Index. Unlike fund shares, investments in U.S. Treasuries are guaranteed by the U.S. government. The S&P 500 Index is unmanaged, and its results assume reinvested distributions but do not reflect sales charges, commissions or expenses.

**Investors should carefully consider the investment objectives, risks, charges and expenses of the American Funds. This and other important information is contained in each fund's prospectus, which can be obtained from a financial adviser and should be read carefully before investing.** Equity investments are subject to market fluctuations. Regular investing does not ensure a profit or protect against loss. Investors should consider their willingness to keep investing when share prices are declining.



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**Finally...**

Hopefully this edition of **HWM ViewPoint** greets you with 2008 tax filing behind you and thoughts of a family trip this summer ahead. Let me take this opportunity to encourage those clients of ours who have not been in to visit us for awhile, to please schedule a review meeting or at least, a review phone call. We'd like to discuss your plans and portfolio, and to consider any changes, concerns or opportunities.

For friends of HWM, could we offer you a second opinion regarding your plans and portfolio?

To all, we wish you the very best and appreciate your support!

**Best Regards,**

Philip C. Henry, ChFC, CFS



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**Disclaimer**

S&P 500 Index is a market cap weighted index composed of 500 widely held common stocks. The Dow Jones Industrial Average is a popular indicator of the stock market based on the average closing prices of 30 active U.S. stocks representative of the overall economy. Past performance is no guarantee of future results. Investors cannot invest directly in an index.

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