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The Bear Headlines

As if the last six months of credit crises headlines weren't enough to cause even some long-term focused investors to consider short-term, "fear-based" selling, the March 17 collapse of Bear Stearns, one of the world's largest investment banks, amounted to a financial St. Patrick's Day Massacre.

Bear Stearns was founded in 1923 and grew into one of the highest-regarded names in the world of international finance. At the end of November, 2007, the Bear Stearns balance sheet listed total assets of more than \$395 billion, of which more than \$35 billion was in cash and nearly \$264 billion was allocated in what were considered "long term investments." The latter category included a variety of mortgage-backed securities. (Source: finance.google.com). Liabilities listed included \$383 billion in total debt. The bottom line is that Bear Stearns had \$11.8 billion in "equity" (assets minus liabilities). Even a 4 percent drop in the company's long-term investments could significantly impact its financial stability!

Poor Market Timing

Less than a week before the Bear Stearns debacle, Jim Cramer, the host of CNBC's Mad Money, was asked by a viewer: "Should I be worried about Bear Stearns in terms of liquidity and get my money out?" Cramer's response, with the knowledge that Bear Stearns stock was then trading at \$63 per share (down from more than \$150 per share as recently as May 2007), was, "NO, NO, NO -Bear Stearns if fine. DO NOT take your money out - Bear Stearns is not in trouble." (Source: CNBC. com).

On the contrary, Bear Stearns was indeed in deep trouble. On March 17, the night of the collapse, Cramer did an about-face, recommending that his viewers sell most of their financial stocks. At that time, the remains of Bear Stearns seemed likely to be acquired by JP Mor-

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gan Chase for a paltry \$2 per share, in a shotgun wedding brokered by the Federal Reserve. Hopefully, the Cramer-faithful did not follow his advice on that day either, since JP Morgan Chase increased its offer from \$2 per share to \$10 per share. Poor Diversification

Not only would Cramer's disciples have suffered by following his poor market timing advice, but it appears that even Bear Stearns chairman James E. Cayne, was over-extended in his own company's stock. Mr. Cayne lost nearly \$1 billion in vested, yet unexercised, Bear Stearns stock options. (Source: Wall St. Journal) These are shares that he could have previously sold and reinvested in a diversified portfolio. Perhaps he held on to the stocks in an attempt to minimize taxes, or maybe he believed that a concentrated Bear Stearns position offered superior upside compared to a diversified portfolio.

If the chairman of a major financial institution, possessing presumably vast knowledge of the financial markets, could lose \$1 billion falling prey to an undiversified, dare I say, imprudent approach, what could happen to the average Joe, who may have a significant portion of his wealth tied to a single or limited number of holdings, not fully comprehending its inherent risks? The average Joe's loss of a few hundred thousand, or even a few thousand, could be more painful.

The Strategic Trio

What is the moral of this story? It is the same that I often write about, this time surrounded by new headlines. The lesson is to base long-term investment decisions on the following strategic trio:

- Asset allocation (determine an acceptable ratio of stocks to fixed income holdings)
- Diversification (across many types of stocks and bonds)
- Rebalance Annually (to maintain desired ratios)

While asset allocation, diversification and rebalancing do not guarantee against losses, this time tested trio can certainly aid in shrinking the volatility that may accompany a portfolio centered on a single, or possibly a few, holdings only.

Stay tuned...very soon another monster headline will most likely emerge, propelling some investors into making an additional round of irrational decisions. Those who have created a sound, long-term investment strategy will be able to rest easier, despite sensational events.

Rebalancing assets can have tax consequences. If you sell assets in a taxable account you may have to pay tax on any gain resulting from the sale. Please consult your tax advisor.



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