

IN SEARCH OF...RECESSION

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I recently received a call from a subscriber of this newsletter. He was quite distressed regarding all of the volatility in the markets and didn't have the faintest idea on what he should do. The first thing I asked of him was what his time frame for his investments. He seemed a little taken back or surprised by the question; he paused and answered, "One year."

Truth be told, investing in the stock market with such a short time frame is a risky proposition. Stocks are long term investments that need work, time, and effort to allow for the magic of compounding to work; and create wealth. I realize that nobody, myself included, enjoys opening up an account statement and seeing the values drop. What I am asking all of our listeners and readers to do is to follow the advice of the Terminator/Mr. Universe/Commando/Predator killer himself.

One of the most exciting moments into my foray in broadcasting was the opportunity to broadcast my show from the Republican National Convention in 2004. One of the highlights was standing on the floor of Madison Square Garden listening to Arnold Schwarzenegger give an inspirational address with the sound bite of the convention...

"Don't be economic girly men!"

If you have a diversified portfolio consisting of high quality dividend paying securities, turn off the CNBC. If you have a long-term goal oriented financial plan, tune out the talking heads and live your life. Most of the financial industry including the media is enriched by individuals acting out of fear in an irrational manner. Do you honestly think that those really cool-looking day traders with the surfboards, parachutes and mountain bikes in the commercials are real? Quite frankly, I find it more believable that Mr. Schwarzenegger would be able to single handedly take out an entire brigade of bad army guys, like he did in the film *Commando*. It is pathetic and disheartening that brokerage firms are allowed to air testimonials written by Madison Avenue advertising agencies while utilizing the same actors from the commercials hawking Viagra and Cialis.

When I was kid, my mother used a make-believe monster as leverage to scare us unruly Markowski kids into submission. She called it the *Mutchker*. (I am not sure on the spelling of this horrible monster and it's surprisingly not in spell-check.) The media has conjured up their own version of the *Mutchker*, which goes by the moniker...**Recession**.

What is a recession?

Business cycles are made up of periods of economic expansion and recessions, when the economy is contracting. The recession monster judge is the business cycle nominating committee of the 87-year old National Bureau of Economic Research, a non-profit group based in the socialist enclave of Cambridge, Massachusetts. The 600 recession hunters of the NBER defines a recession as a significant decline in economic activity spread across the economy, lasting more than a few months that is visible in measures such as gross domestic product, employment, incomes and industrial production.

The media networks should bring Leonard Nimoy back to restart his really cool 1970's show *In Search Of*. Episode one could be *In Search Of...Recession*. The scary recession monster shows up with less frequency than Big Foot or Loch Ness Monster. According to the recession hunters of the NBER, there have been 32 recessions since 1854, lasting an average of 17 months. Interestingly enough the recession monster has become more elusive since 1945. The last two

sightings were among the shortest and mildest on record; both the 1990-1991 downturns and the recession of 2001 lasted just eight months. Recessions have become rarer and less severe due to global warming.

Just kidding! (However, I did read an article this past month that tried to correlate the subprime crisis and global warming)

Technology, productivity and business efficiency have allowed for manufacturers the ability to foresee problems and reduce excess inventories. Supply-chain management and business efficiency changed our economic dynamic to such a degree that many companies can reduce their payrolls with attrition rather than layoffs. The Wall Street Journal points out that from 1945 to 1981 recessions were principally caused by the Federal Reserve raising interest rates to suppress inflation therefore undermining the demand for houses and cars. During the recent crisis the Fed did not raise rates very high, and home construction has already fallen by half since 2006. This would suggest that much of the damage to the economy has been already felt. An area of concern however is home values. The decline in home values will hurt overextended borrowers and could lead to greater defaults and more problems for banks. In turn banks might be more reluctant to lend. In my opinion, this will not happen. Banks will most certainly tighten lending standards, which is prudent. Contrary to the beliefs of certain politicians, everyone is not entitled to a loan. On the contrary, I believe individuals and businesses with solid numbers will have no problem accessing the capital markets. Banks want to lend money, that's how they make money.

The conventional wisdom pushed upon the investing public holds that equities along with the economy will head south during a recession. The reality is that stocks usually drop before a recession; something that could possibly be happening now. However, once a recession is declared the market looks forward to a recovery and equities start to respond favorably to the expected end of a recession well before it actually occurs. One of my favorite pundits and economist Donald Luskin of Trend Macrolytics recently ran the numbers and found that stocks have produced an average return of 12.1 percent in post-World War II recessions. This is only slightly below the average return outside recessions.

The million dollar question that everyone seems to be asking or fretting about is whether or not we are currently in a recession. My answer to this is simply...

"I don't know, and quite frankly I don't care."

A recession should not change a long-term investor's philosophy. What is the point of getting all bent out of shape over a recession monster that rears its ugly head with the frequency of the Loch Ness or Big Foot monster? I am by no means declaring the end of the business cycle. We will more than likely experience a recession in the next 100 years; however waiting for one or even trying to predict and time them is an exercise in futility. If we do have a recession...so what? It won't last forever.

CNBC is loving life right now. Business is booming. The business news networks, that push the narcotic-like trading addiction with incredible ferocity, is basking in glory with all the recent volatility. Unreasonable and volatile markets make for great headlines and fantastic ratings. You will be surprised by these numbers, when things are not so exciting in the financial markets, on an average day, CNBC is only viewed by about 283,000. Even worse, the New York Times reports that the new Fox Business Network is drawing about 6,300 viewers each day. (Full disclosure...I think Fox's business programming is horrible, aside for Neil Cavuto; and I have strong contempt for much of CNBC's shows.) Individual investors need to realize that the advice and points made on such shows are usually nothing more than money managers pitching their

own book of business. These shows are for industry insiders; and in my opinion, should offer up the *“Do not try this at home”* disclaimer used on television shows like Fear Factor.

The truth about investing is timeless and irrefutable. I didn't create the formula and neither did Buffet. Investors get their daily economic and market fill from the mainstream press. If the media lets on that their endless drumbeat of buy, sell, recession, IPO, dot com, hot funds, etc. is for all intents and purposes, unnecessary and even dangerous; they would be out of business. How could they possibly discuss long-term goal oriented investing in a 24 hour news cycle? Think about it...Their two highest rated programs are entitled Mad Money and Fast Money. Intelligent Investing for the Long Run and The Compounding Hour don't sound as compelling.

We have the fiduciary responsibility to preach truth to the news. One of the greatest investing truths: The primary obstacle to achieving real goal achieving returns is not investment performance but rather investor behavior. The critical variable isn't what **your** funds do. It's what **you** do.

What should one do when confronted by the recession monster?

Fact: There has never been a correction in the overall market that has not proven to be an investment opportunity. The greatest buying opportunity of the past 30 years happens to be the day after the October 1987 crash. When equity positions are down in price, it can be difficult or painful to watch. Nobody yearns to open their account statements and see paper losses. However, if you own quality, value, and fundamentals, with a focus on your long-term goals, you shouldn't lose sleep at night.

Corrections separate the men from the boys. They can test the faith of the most ardent value/fundamental oriented investor. Being fixated on your portfolios market value during a calamity, you will just give yourself a strong case of indigestion.

Do not try to predict market bottoms or tops. One thing that we at Markowski Investments are incapable of doing, Warren Buffet is incapable of doing, and most certainly all the chattering classes on CNBC are powerless to do, is predict the up's and downs of the market. No mortal human being can time the market; it is a complete waste of time and an exercise in futility trying to do so. Exercise a value, compounding interest, long-term approach. Understand and follow the Warren Buffet edict that ***“Over time, markets will do extraordinary, even bizarre things.”***

We at Markowski Investments know that certain beliefs and behaviors can help individuals to achieve better lifetime returns than the proverbial “hamster wheel” that is constantly pushed upon them. Investors need to follow and abide by a belief system that will aid in navigating them through any financial storm, no matter how unpredictable or ferocious.

Investors, for lack of a better phrase, need to *“suck it up”* and have faith in their financial plan when the going gets tough. Market corrections do not last. Solid goal oriented plans do. It is impossible to invest successfully in a future of which one is fundamentally afraid. Thus, the great enemy of investment success isn't ignorance, but fear. All human experience goes to teach us faith in the future, and especially faith in the American economy and its markets. The problem arises when the media suggests that some economic or market setback is new and different; terrible in an unprecedented way, and therefore a disaster you'd better jump clear of. The interesting thing is that the more inconsequential the disaster (Katrina, oil, or most recently subprime), the greater the volume of fear mongering. Time and time again these ***“crises”*** pass and the faithful investors are rewarded while the non-believers are punished.

Patience is a virtue; an old cliché that needs to be a part of an intelligent investor's belief system. Understanding and building your financial plan around a time frame is imperative. Don't concern

yourself with ***“what is working now,”*** but rather what will work over time (value, fundamentals, and dividends). Investors need to be disciplined. Paying oneself first is a discipline. Funding your long-term plan before (and, if necessary, instead of) buying the latest flat-screen or grabbing that great deal on a Mercedes is a discipline. Funding that plan regularly, month in and month out, as opposed to the typical *“Maybe we better hold up for a while until this market stops going down”* is a discipline. Investors **must** be disciplined. Navigating storms, even of the complex nature that we have all recently witnessed, is quite simple: Follow the belief system described above (faith, patience & discipline). Divert from this belief system and often a heavy price will be paid.

As it turns out the dastardly *Mutchker* turned out to be nothing more than an old wig. Recessions and market corrections are equally innocuous. Don't let the media's end of day's portrayal and perceptions of the world become your reality. Make the conscious and difficult decision to take the recession market correction for what it really is, an opportunity.