

Is This 2008 All Over Again? We Don't Think So.

With credit downgrades of U.S. and European debt, tremendous volatility in equity markets, plummeting interest rates, and rising gold prices, it certainly feels as though another financial crisis is unfolding before our eyes. It has been just over three years since the collapse of Lehman Brothers. At that time, depositors scrambled to determine if their savings were covered by FDIC insurance, people worried ATMs might stop dispensing cash, short-term lending froze completely in many industries, and the U.S. Treasury Department urgently asked Congress for \$700 billion to prop up the financial sector. The Dow Jones Industrial Average has gone from 14,164 in October 2007, to 6,547 in March 2009, back up to 12,810 in April 2011, and now back to 10,913 at the end of this quarter.

Investing in stocks certainly has not been for the faint of heart. It is troublesome to watch portfolio values decline again after the all-too-recent historical drops of 2008/early 2009. Are we experiencing another 2008-style financial crisis, or is this just the protracted unwinding of broader-based debt problems—both public and private—that accumulated over the last quarter century? We think it is the latter. The debt problem cannot be remedied overnight or without some painful choices. The U.S. and many world economies are still healing and returning to greater productivity and growth.

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Questions?

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Index	Asset Class	Third Quarter 2011	Year-to-Date 2011
Short/Intermediate-Term Bonds	Fixed Income	2.4%	4.9%
S&P 500	Large U.S. Stock	-13.9%	-8.7%
Russell 2000	Small U.S. Stock	-21.9%	-17.0%
MSCI EAFE	Foreign Stock	-19.0%	-15.0%
Dow Jones REIT	Real Estate Securities	-14.5%	-5.2%

Adviser Corner



ALANA C. ASMUSSEN, CFA, CFP®
PORTFOLIO MANAGER

Alana joined Dowling & Yahnke in 1995 and has been a key participant in the development of the firm. She holds the designations Chartered Financial Analyst (CFA), CERTIFIED FINANCIAL PLANNER™ (CFP®), and has a Master's Degree in Business, Financial Planning (MS) from San Diego State University. She completed her undergraduate work at the University of Iowa with a Bachelor's Degree in Business and Economics.

Alana is a member of the CFA Institute, the Estate Planning Council of San Diego, and is a past President of the CFA Society of San Diego, Inc. She is active in P.E.O., a women's philanthropic, educational organization. Along with being involved in the community, Alana is an avid world traveler. Born and raised in Iowa, Alana moved to San Diego in 1992.

The uncertain economic environment is clearly affecting investors who are purchasing high quality government debt in large quantities, while forgoing attractive dividend yields and the potential for capital appreciation in stocks. High debt levels are on the verge of crippling some European nations, notably Greece, causing instability in the euro and driving investment flows to the safety of U.S. Treasuries and the U.S. dollar. On both sides of the Atlantic, movements in the securities markets are becoming increasingly tied to political issues and less to economic fundamentals. The stagnant labor market is another source of frustration, with U.S. unemployment still hovering around the 9% mark, despite healthy corporate profits, substantial available capital, and the implementation of a \$787 billion stimulus package.

Three years ago, at the end of September 2008, the 10-year Treasury note yielded 3.85%. By the end of the third quarter, the yield on this benchmark note had fallen all the way to 1.92%. Interest rates are close to historic lows across all maturities, reflecting an incredible appetite for "risk-free" assets, particularly while the European debt crisis drags on. Even some of the most revered professional bond investors have been surprised by the power of this year's rally in bond prices; through September 30th, the benchmark bond index has returned 4.9%. It bears remembering that, generally speaking, bonds held to maturity offer no opportunity for capital appreciation, and today's extremely low yields are uninspiring at best.

While the stock market has been incredibly volatile, at today's levels stock valuations appear attractive. Corporate profits are much higher and corporate balance sheets are far healthier today than they were three years ago. The S&P 500 basket of companies produced earnings of \$50 in 2008 versus the current one-year forward estimate of \$100. Corporate cash balances are in excess of \$2 trillion. CEOs are frequently quoted saying, "Our businesses are okay," as they extract increasing productivity from fewer workers at lower cost structures. Today, the S&P 500 Index is valued at a forward price/earnings ratio (P/E) of 10.5, a discount of about 17% from its value at the beginning of 2008. It is also interesting to note that for the P/E to reach its five-decade average of 16.4, either the S&P 500 would have to advance approximately 50% above the current index level or corporate earnings would have to collapse.

We will not pretend that everything is sunshine and roses, but when people say to us, "I just don't see anything good out there," we tend to disagree. We do not believe this is 2008 all over again. Nor is it likely the end of stock market volatility as we have come to know it. But if you look beyond what markets are doing today to the long-term expectations for a well-diversified portfolio, we think stocks will provide growth and protection from inflation. We also think that bonds continue to play an important role in mitigating the volatility of the stock portion of a portfolio. At the individual level, it will always be important for us to help our clients determine the best mix of both of these assets classes for their particular situation.

Today's problems are substantial, and it will take significant sacrifices from all to get the economy back on track. Although it is hard to be optimistic, we are. As Americans have done throughout history, we believe that we will overcome the current adversity and create a brighter future.

We Have Updated Our Website

In celebration of our 20th anniversary, we have recently redesigned our website. The new design is meant to make our site easier to explore and to provide helpful information about Dowling & Yahnke, including links to contact our team, details on our services, and highlights of our activities in the San Diego community. As part of the new design, we have incorporated our blog which features interesting, topical articles. To learn more, please go to www.dywealth.com. We welcome your feedback.

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Dowling & Yahnke
WEALTH MANAGEMENT
DISCIPLINE · INTEGRITY · KNOWLEDGE
Celebrating 20 Years