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THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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Serving Investors Since 1982

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Greetings from The Personal Wealth Coach!

Attached is the letter I will be including with the quarterly reports we send to those of our clients who receive them. I thought that it might be useful for the rest of you as well, so here it is!

It was a rough quarter, but third quarters are very commonly so at the bottoms of economic cycles and at the end of bear markets. If history repeats itself, then we should be seeing a nice market value recovery between now and the end of the year. As the letter explains in a bit more detail, during years when the market "corrects" (falls) during the third quarter while the economic data is actually improving, the 4th quarter tends to be a really good time to be invested. The reverse of that happens when the markets rise over the summer in the face of declining data.

Despite the feeling of impending doom, the data have been getting better, not worse. Today's employment report is an example of that improvement. No, the slow-growth period is not over for the economy, but we are not heading into the pit. As I wrote earlier, until we deal with the debt overhang both here and in Europe we are in for a long, slow slog. That is completely different from a decline though.

I expect that you will hear a lot of negative commentary in the remainder of this year and through 2012 as well. The news media is on a roll and as the old saying goes, "Bad news sells papers." That works for television, radio, and web-pages as well. The news media thrives on bad news and the party not holding the Presidency is more than willing to supply it.

It is important too, to remember that in the final analysis we are not investing in the GDP, employment, or the health of the European Monetary Union. We are investing in for-profit corporations that have managed to turn out record profits in the midst of all else that is going on. They also are sitting on the largest cash reserves, both in terms of number of dollars and in terms of a percentage of assets, that has ever been recorded. It may take a while for investors to recognize those realities, but they are present. One of the least understood secrets of successful long-term investing is that we must buy (or hold) investments when things look the worst if we want to profit when the traders come to their senses. Warren Buffet understands that. So has every great investor in the history of the markets.

If you have any questions or comments, don't hesitate to contact me.

Jeff

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Something Wicked This Way Comes

The Force of Fear

The stock market decline in the third quarter of this year (July-September), are a proof of the force of *fear*. Even as corporations report increased earnings and the GDP is revised upward, the market has continued to act as if the end of the world was at hand. The Dow Jones Industrial Average fell about 12% for the three months. The S&P 500 Stock Index fell about 14% for the same period.

Last week, the stock market seesawed up and down as much as four or five percent per day. The Reuters News Service headlines at the end of each market day were quite revealing as to why. Two of those headlines (the bolding is mine):

- *Stocks Drop, led by Commodities on Economic **Fear***
- *Stocks rally on Europe Debt **Optimism***

Traders are vacillating between **Fear** and **Optimism**. I want you to consider that neither of those is *real*. They are *feelings*. In the end, the values of things we own do not depend on our emotions, but on the hard-nosed reality of economic principles.

Even the *fear* itself is not at all well defined. The number one “wicked” something that people seem to fear is the default of Greece. I have written this before and I will probably get to write it again. *Greece is going to default*. The numbers are very clear. Greece absolutely cannot afford to pay its debts.

The fear appears to be that if (when) Greece defaults, European banks and nations will become insolvent because they have large holdings of Greek bonds. Investors seem to fear that the chain of defaults that follows will be more severe than that following the Lehman Brothers default back in 2008-2009. Greece is not Lehman Brothers. With Lehman, there was a massive worldwide unpreparedness. There is ample evidence that preparations are being made in every institution and nation across Europe and the United States.

The second “wicked” thing we seem to fear is that something terrible is about to happen here in the United States. Among those who express that fear, the consensus seems to be that it will come because of the nefarious activities of the President. Beyond that, I have been unable to nail down any specific terrible event that they fear.

When John Kennedy was President, I listened as conservatives insisted that the Pope would set himself up as the ruler of America (Kennedy was our first Roman Catholic President). I again listened as very intense, left-leaning college students insisted that Richard Nixon was going to stage a coup and become dictator. While Jimmy Carter was President, conservative friends of mine insisted that the Trilateral Commission was a front for the “one world government” that would take over and enslave us all. During George W. Bush’s presidency, the conspiracy theory (from the left) was that Halliburton was secretly running the government and the wars in Iraq and Afghanistan were solely for Halliburton’s profit.

In this age of 24 hour news channels, cell-phones, and mass email forwarding, conspiracy theories and urban myths can easily “go viral” and be widely believed. That does not make them more real or less damaging.

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The Wicked “Something”

I have taken the title of this letter not from its origin in Shakespeare’s *Macbeth*, but from Ray Bradbury’s novel by that name. In Bradbury’s novel, fear gradually settles over a small town as a carnival arrives late in the year. It opens with a lightning-rod salesman warning that, “A storm is coming.” The scene is set quite literally in the “fall” of the year. The carnival is indeed an evil mechanism that exists to imprison the carefree souls of young boys. Very critically, *fear* is the only weapon Mr. Dark, the master of the carnival, has at his disposal. Laughter, dancing, and singing free the children’s souls and the loving embrace of a father destroys the power of the carnival master.

The “something wicked” that comes in the novel is *fear*. Securities markets tend to be moved in the short-term by the twin emotions of fear and greed. The highest levels of volatility in the market come near the top and the bottom of market cycles as the adherents of those two emotions battle it out. If in the relatively recent past the optimists have been the dominant force, then market values are likely to reverse course and decline substantially. If in the past couple of years there has been a great deal of pessimism and fear, then it will not be long before the market starts back up. These reversals can take months, and sometimes many months, but the end of the high fluctuations is almost always a mark of the reversal of sentiment.

Right now, it is clear that as a whole, those corporations listed on the exchanges are doing quite well. That is where we invest. We do not invest in the unemployment rate or the GDP. Those are indicators, and they are important indicators, but even in times when unemployment is high and the GDP is in bad shape, there will be companies that are turning a nice profit. As an example, the employment reports consistently reveal that companies are hiring and the government is laying-off workers. The net result is high unemployment, but it is mostly in local and state governments where that is occurring. Fortunately, our investments are not in governments!

The Thing That is Really Coming

At some point, the greed factor will overcome the fear factor in the markets. If history is any guide, that will happen sometime between now and the end of this year. I only say that because it is such a consistent pattern in history. If we analyze the data again at the end of the year we may find that nothing has actually changed. What will likely make the market indices rise is simply a reversal of sentiment.

When there is a legitimate reason for concern evident in the underlying economy, the pattern we commonly see is gains in the summer followed by a decline beginning in October. When the underlying economic reality is solidly profitable, but baseless emotion forces the market values down, then we typically see losses in the summer and a reversal to the upside in late October. The stock market peaked in October, of 2000 and again in 2007. In retrospect, during the summers we now can see as the ends of the bull markets, values rose in spite of bad economic data. During the summers at the end of bear markets, market values tended to fall despite improving economic data. “It’s Déjà vu all over again.” *

My reading is that the car and truck count on I-35 is growing. The parking lots at the outlet malls are full. Here in Salado, we just had what appears to be a record-shopping weekend. If that pattern holds, then things are getting better and the stock market will respond. It is not so much a matter of “if” as “when.”

As always, if you have any questions or comments we are available.

Sincerely yours,

Jeffrey W. McClure, CFP®

*Quote from that wise sage of New York, Yogi Berra.