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## 2008 in Review

What comes next?

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*by Neal Frankle, CFP*

Most investors are happy that 2008 is over.

Throughout the year, home prices and consumer confidence fell. Stock prices dropped and unemployment rose. Holiday shopping was the weakest in decades. All told, 2008 was gloomy.

When the final numbers come in, we'll likely see that the economy contracted by more than five percent in the fourth quarter of 2008 after contracting 0.5 percent in the third quarter.

### The Past

But stocks have been rising lately. What gives?

"What gives" is that there are always two sides of the coin. There have been powerful forces at work that may help revive the economy. Energy prices have cratered more than 70 percent. Mortgage rates have been slashed and the Federal Reserve has taken aggressive action to breathe life back into our system. And President-Elect Obama plans on injecting more than \$850 billion into the market by investing in infrastructure, social programs, tax cuts and aid to states. Some experts think that our economy could start to recover during the second quarter of 2009.

So far however, low mortgage rates and slashed energy costs have failed to revive the economy. Home prices are 23 percent off the July 2006 peak. Over-hyped markets like Phoenix, Las Vegas and San Francisco are off more than 30 percent. Consumer confidence is at a 16-year low. Job losses are steep. Unemployment is up to 6.7 percent -- a 15-year high. Many expect unemployment to rise to eight percent by mid-year. Even though gas prices are much lower, those price reductions have failed to overcome the fear of being unemployed. That translates into lower spending and terrible retail sales.

### The Future

What can we expect going forward?

I think it's safe to say that we're going to see a return of big government. We'll see more spending, more debt and more regulation.

What about the market?

Last year was one of the most punishing years for investors in decades. The S&P 500 plunged 38.5 percent and the NASDAQ 42.5 percent. But as we enter 2009, stocks are actually showing some signs of life. Believe it or not, since the November lows, the market has been in an uptrend. We may not be out of the woods just yet. (And my guess is that we are not.) Just the same, this is yet another example of how the market often moves independently of the economy.

Just because the economy is still weak, it doesn't make sense to assume that the stock market will remain so.

Typically, the market recovers long before the economy does because the market is a reflection of investors' expectations of future corporate future profits.

As I said, there are a few changes that may in fact help businesses and consumers going forward. Significantly lower gas prices and interest rates help reduce the cost of doing business and help put cash in spenders' pockets. Also, many companies hold huge cash positions. That will help them weather the current economic storm and take advantage of opportunities as they unfold. And investors hold \$8.9 trillion in cash. This was money that was pulled out of the stock market. When those same investors pile back into the market, they could create the conditions for a huge market rally.

I'm trying to reinforce what you already know. The market is not predictable. We have countless examples of this too. From its high in 1929 to its low in 1932, the S&P 500 dropped 89 percent. We all know this. But what few realize is that over the next three years, the market shot up 206 percent. From late 1972 through October 1974 the market lost 48 percent of its value. But it jumped 73 percent over the following two years. And during the bear market of 2000 through 2002, stocks fell 49 percent only to rise more than 100 percent over the next five years.

Sure, values are down now and they have been for more than a year. That's enough to try the patience of even the most cool-headed investors. But while prices may stay low (or go even lower) what does history tell you will happen after that?

### **The Present**

Right. History argues that prices will rise. But history also tells us that when the recovery comes, it does so quickly. And it happens before most people notice. Case in point: the market has increased by 24 percent in the last six weeks. And it happened without anyone really paying attention. Do we have any reason to believe that anyone can predict what is going to happen in the market during the next six weeks, six months or six years?

Today's low prices may represent one of the greatest buying opportunities of a lifetime. We'll only know that when we look back five years or 10 years from now.

### **Conclusion**

I think it's very important to learn from our experiences and at the same time be aware of the tendency to let our most recent experiences color our judgment. When the market trend is up, most folks expect the market to go up forever. After big declines, few of us can see the

possibility of recovery.

By now, we all know that bear markets can happen. But its time to point out that rallies and bull markets are normal too. In fact, the market goes up far more often than it declines.

I believe that there are opportunities in the wake of these steep declines. The critical point is to make sure your clients face this investment environment from an objective rather than an emotional position.

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**Neal Frankle**, CFP, is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. If you would like a free monthly e-newsletter (written especially for CPA's to use with their clients so they make better investments) please e-mail [Neal](#). Frankle is a contributing writer of *AICPA Wealth Management Insider*. His views as expressed in this article do not necessarily reflect the views of the AICPA or the *AICPA Wealth Management Insider*.

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