



Registered Investment Advisor

STEIN WHITTINGTON DENIEL INVESTMENT ADVISORS

Wealth Manager

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CAN WE MAKE SENSE OF THE NERVOUS MARKETS?

In 1957, Bernard M. Baruch, one of the greatest investors of all times, stated in his autobiography "My Own Story" words which ring truer today: "If anything, too much information may be available today. The problem has become less one of digging out information than to separate the irrelevant detail from the essential facts to determine what those facts mean. More than even before, what is needed is sound judgment." (pp. 261-62). One listening to "talking heads" on TV, radio, etc. can come away with any opinion — bullish or bearish — and seemingly well-reasoned. The essential question, framed by Baruch, requires us to separate out the important facts and determine what these facts mean for the markets.

Between October 11, 2007, and the end of 2007, the DJIA sunk 750 points. Going into 2008, by the middle of March, the DJIA continued and accelerated its decline by dropping another 1525 points (altogether a drop of 2,275 points in the DJIA in about 5 months — more than 16%). The other major indices also dropped precipitously. In all, the equity markets do not get much bleaker.

Basic reasons for the market decline are relatively easy to cite. Some of the best known include: rapidly rising prices of oil, gas, and other commodities (suggesting increasing inflation), collapse of the sub-prime, and other real estate financing instruments, securitization gone awry causing lack of liquidity, and perhaps the most important, a nagging lack of confidence in our economy. Each of these reasons invites a myriad of other

considerations — they involve complex subjects. When so much can be said on both sides of complex issues, the best places to determine what the facts mean is to (1) examine history and (2) search for technical (mechanical) rules which apply to the facts.

History demonstrates convincingly that unusually high market volatility is associated with market "bottoms" not "tops". We have found the CBOE Volatility Index (VIX) to be an excellent indicator, even predictor, of market direction. The VIX serves as a measure of anxiety or complacency in the market — the higher the index, the more anxiety. It is generally considered that a VIX measurement of 40 or even 30 or more represents "irrational fear" — a contra indicator. Beginning in July, 2007, the VIX began to spike several times in to the low 30s and its trajectory headed on a higher path. Fear was definitely in the market. At some point fear always becomes "irrational".

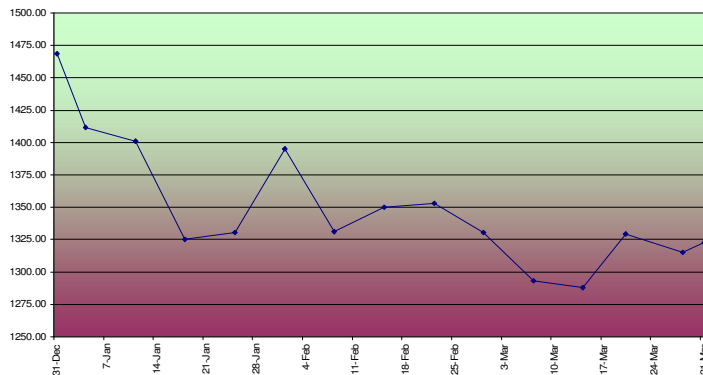
Another important volatility measure, is the Absolute Percentage Change or "APC". APC tracks the daily percentage changes in the DJIA (positive and negative). Within the past few days, the APC has been at a five year high of 1.63. There has not been this much apprehension in the market since the 1.70 reading in March, 2003, shortly before the beginning of a five year bull run. (see Barrons, March 31st, p. 34) To us, these technical factors suggest improving equity markets going forward, even if volatility is not expected to disappear in the near future. Any observer of the market knows that fear has been rampant. We believe that it is precisely these inflection points which often signal a market reversal and, in turn, a better market psychology. The dramatic market action on April 1, 2008 (DJIA up 392 points, S&P, up 47 points, NASDAQ, up 84) may confirm the point.

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THE QUARTER IN REVIEW

SP 500 INDEX

Jan 1 - Mar 31, 2008



Whether or not we are in a recession presents an esoteric question. The sharp market declines which began last October, accelerated in 2008. As the feature article on page 1 discusses, volatility has increased. Daily swings, in opposite directions, of 1% or more in the major averages have not been uncommon during the past five months. However, swings of this magnitude are uncommon if one examines the history of market volatility. Precipitous drops as experienced during the past five months are also uncommon. During the first quarter, the DJIA was down 7.6%, the NASDAQ Composite down, 14.1%, and the S&P500 down, 9.9%. The only market sector which performed positively during the quarter was the DOW Transports, up 4.6%.

Although it has not been discussed as much as it deserves, the collapse of Bear Stearns, and the rescue by JP Morgan Chase (made possible by decisive Fed intervention) may have been a true inflection point. Had Bear Stearns filed for bankruptcy, the ensuing failures could have led to the worst financial debacle in the history of America. Yet, we pulled back from the brink. It is now fairly clear that the sub-prime mortgage mess is much broader than previously believed, but rational minds in the Treasury Department and the Fed are cooperating and dealing realistically with these enormous issues. The market action on April 1st suggests that the average investor appreciates a more realistic approach. Fear, which had reached very high levels, may be subsiding.

Strange as it may sound, geopolitical events have quieted a bit during the past quarter. At the time, some pundits suggest the boom in commodities may be nearing a correction. No doubt the politics of the presidential election have given rise to some unfortu-

nate language and accusations. However, in fairness, the American people should understand that political speeches of this nature should not be taken too seriously.

We at Stein Whittington Deniel remain cautiously optimistic with respect to the outlook for the remainder of 2008. Other reasons also support our prognosis. Bernanke and the Fed have, in our opinion, acted responsibly — indeed, possibly avoided a depression with the Bear Stearns intervention. The world economy remains strong and the exports from the United States are in good shape aided by a weak dollar. While one can quarrel about the political and security implications of foreign wealth funds providing critically needed funds to many of our financial institutions, the fact remains that billions have recently been invested in the American financial industry by foreign investors.

Our firm's conservative Covered Call strategy works especially well in this type of high volatility environment since call premiums are directly correlated to volatility: Higher volatility, higher premiums.

Interview on Television: Rick Stein's interview with Randy Alvarez about Covered Call Writing and our company continues to show on Channel 7 about 10 times a month. Please call if you would like to know the times the interview will air.

Schwab Alliance: If you haven't done it yet, please remember to call the Schwab Alliance Team (800) 515-2157, #3 in order to request enrollment in electronic delivery. Please ask to enroll in e-Confirms, electronic delivery of annual reports and 10K's and e-Statements. This will entitle you to receive reduced commissions on equity trades and avoid the clutter in your mail box. Schwab continues to improve its website offerings, including viewing statements and 1099 tax reports.

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