



SILVERCREST
ASSET MANAGEMENT GROUP

FROM IRRATIONAL EXUBERANCE TO IRRATIONAL DESPAIR

With the stock market either in a state of desperation or capitulation, fear is an abundant commodity among investors. The following are comments that summarize our current position on the economy and the market:

- (1) The odds of a *brief* recession have increased in recent days as the impact of the subprime mess seems to be spreading into the production/consumption side of the economy at the same time that global growth appears to be slowing.
- (2) It seems quite likely that the recession, if it develops, will cover the second and third quarters of 2008 with a decline of no more than about 1%. This is because the U.S. has not accumulated significant excesses in the most recent expansion. As a result, other than housing, there is very little to be absorbed.
- (3) The key central banks are cooperating rather than challenging each other. Despite a whiff of inflation, both in the U.S. and elsewhere, the Fed and other monetary authorities are leaning toward easing in addition to being willing to provide the necessary liquidity.
- (4) Washington is quite aware of the need for fiscal stimulus. Both major political parties are in agreement and are likely to rapidly forge a program that would quickly benefit consumers.
- (5) The stock market is not expensive. In fact, at 15.7-times earnings for the S&P 500, its P/E is less than half of the 35x from which the bear market of 2000-2001 began. Furthermore, today the S&P 500 and the Dow Jones are lower than they were six years ago, while the NASDAQ is down 50% from its peak. Meanwhile, S&P 500 profits are up to about \$87.00 from the prior peak of \$56.00, recorded in 2000. Excluding the financials, profits should be higher this year than in 2007.
- (6) Outside of the financial sector, corporate balance sheets are quite strong, cash flow is abundant, and managements are very disciplined. Therefore, while earnings *in general* might decline due to the write-offs from financials, the other sectors of the market might well report steady or rising profits even during the recession.
- (7) In nearly all of the recessions experienced in the U.S. over the past 60 years, the stock market began to recover in the middle of the downturn. Therefore, history suggests that while the next few weeks might be difficult, a market recovery may begin shortly near mid-year.

- (8) The large cap and megacap sectors of the market are more undervalued than the small caps, in our opinion. However, the small caps have rapidly separated into some companies that remain overvalued and others that have become quite depressed and on the bargain counter. Many small caps are down 50% or more over the past 90 days or so without any negative news.

Despite the difficult market conditions, I am not discouraged. I consider what is happening an opportunity to take a fresh approach and replace or reduce some of the names that have done well but have become somewhat overvalued or overweighted.

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Stanley A. Nabi, CFA
Vice Chairman

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