

Hurricanes

In September 2008, Hurricane Ike sped toward an historic rendezvous with the Texas coast. Early estimates put the property damage at \$16 billion, dwarfing the state-led insurance pool developed to offer hurricane insurance. More than 3 million homes and businesses in Ike's path lost power.

Perhaps more remarkably, portions of the coastline and the barrier islands reportedly were altered beyond recognition, and will never be as they were before.

Financial storms

Also in September, the credit crisis that began over a year before came to a head. In a series of transactions that would have been unthinkable just a year ago, the federal government placed mortgage giants Fannie Mae and Freddy Mac into conservatorship, allowed the venerable investment bank of Lehman Brothers to fail, came to the aid of insurer of AIG with \$85 billion, and oversaw the sales of giant financial services firms Merrill Lynch to Bank of America, and Washington Mutual to JP Morgan Chase.

And that was just the warm-up.

These extraordinary steps were still not enough to bring calm to the financial markets. Treasury Secretary Paulson asked for \$700 billion to help remove the most "toxic" assets from troubled banks. A week of political wrangling over the plan was capped by its narrow rejection in the House of Representatives. That same day the Dow Jones Industrial Average lost just over 777 points, the largest single-day point decline in history, an estimated loss of \$1.2 trillion.

The \$700 billion package was rescued in the Senate, when a one-year boost to the FDIC insurance limits and important tax benefits were attached to it. The House acceded to the Senate's wisdom.

Whether or not the legislation achieves its purpose, just like the Texas coastline, our financial services environment will never look the same as it did before.

The economy

Ironically, the turmoil in the financial markets occurred even as many other economic indicators suggested that a recession had not yet begun. The economy grew through the entire first half of the year, albeit at modest levels. Growth in the second quarter was revised to 2.1%, suggesting that some sectors of the economy remained healthy. Unemployment, rising to an unwelcome level of 6.1% in August, stood far short of the levels seen in recessions past (7.8% in 1991, 10.8% in 1982).

Still, the financial markets are the circulatory system of the economy, and trouble there must eventually spill out to other areas. New car sales were hammered by high gasoline prices during the summer, then by scarce credit for purchasers in the fall. Ford sales were down 34% in September, and Toyota car sales fell 32%. GM, with only a 16% fall-off, was pleased to note an increase in its overall market share, to 27%. Factory activity in September fell to levels not seen since October 2001.

Stocks

It's been a very poor year for equities. But as bad as American investors may feel, many foreign stock markets have done still worse. The Shanghai Composite China index, for example, was down nearly 60% for the year as the fourth quarter began.

Investors want to know when the bottom has been reached. There's a powerful temptation in bad times to move to safer investments. The trouble is, such a move can lock in losses at the bottom of a market, and it runs the risk of being out of the market when stocks begin to move up in the future. On the other hand, with all the political talk about being at the brink of another Great Depression, investors can be forgiven their anxiety. Nevertheless, the focus needs to be on the longer term.

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