

## Market & Wealth Management Update January 31, 2009

### Stocks Swoon Anew as Financial Companies and U.S. Economy Falter

The Dow Jones Industrial Average turned in its worst January on record to start 2009, falling 8.8% while the S&P 500 dropped 8.6%. The decline in the Dow was the fifth consecutive month for the index but, despite the losses, the Dow still stands 8% above its November lows. Foreign markets started the year similarly weak, falling nearly 10% as measured by the MSCI EAFE index. The table below presents data for stocks, bonds and oil for the month.

Several points can be taken from the month's data, including the continued low price of crude oil and the low rates of interest earned on U.S. Treasury securities. The U.S. economy slid further as fourth quarter GDP data confirmed a major slowdown with a -3.8% reading, the largest decline since 1982. In this update we touch on the stock market's continued weakness, some of the underlying factors and give an update on recent economic news. The chart below shows the path of the U.S. stock market in the past six months, as measured by the S&P 500.

<b>Market Statistics</b>		
<b>January 31, 2009</b>		
	Level	YTD%
Dow Jones	8,002	-8.8%
S&P 500	826	-8.6%
NASDAQ	1,476	-6.4%
MSCI EAFE	1,115	-9.9%
Oil (WTI)	\$41.68/bbl	
Barclays Cap	-0.9%	
Agg Bond Index		
Yields		
Federal Funds Rate	0 -0.25%	
6 Mos Treasury Bill	0.27%	
2 Year Treasury Note	0.95%	
5 Year Treasury Note	1.88%	
10 Year Treasury Note	2.84%	



### Company Earnings as Low as We Expected, But Lower Than Expected by the Market

The most important information for investors thus far in 2009 has been the earnings data from both domestic and foreign companies. As we have noted before, our analysis has led us to question most companies' and Wall Street analysts' earnings guidance given the economic and financial conditions. In early 2009 earnings numbers and warnings have been as weak as we expected, but unfortunately more than the market anticipated. Financial sector stock prices in particular have been plagued again by continued write-downs, with the sector down 26.5% so far.

Early in 2009, well regarded panelists of market roundtables predicted market increases of as much as 20% for the year, based in part on earnings numbers that implied double digit rates of growth. Our quantitative work suggests a low probability of growth in S&P 500 earnings this year. Therefore, we have been holding estimates flat for 2009. On a per share basis, this would put S&P 500 earnings at \$65. Those predicting double digit growth this year predict a \$75-80 level. Several well-regarded analysts have recently lowered their estimates to \$55.

What do these earnings per share numbers of the S&P 500 mean for the current market and investors?

**On a current year basis, the estimated earnings per share for the S&P 500 of \$65 implies a market valued at 13 times earnings (P/E), which is only slightly below fair value. In the event that earnings end up being only \$55 per share, the market is valued at 15 times earnings, close to the long-term average of price/earnings ratios.**

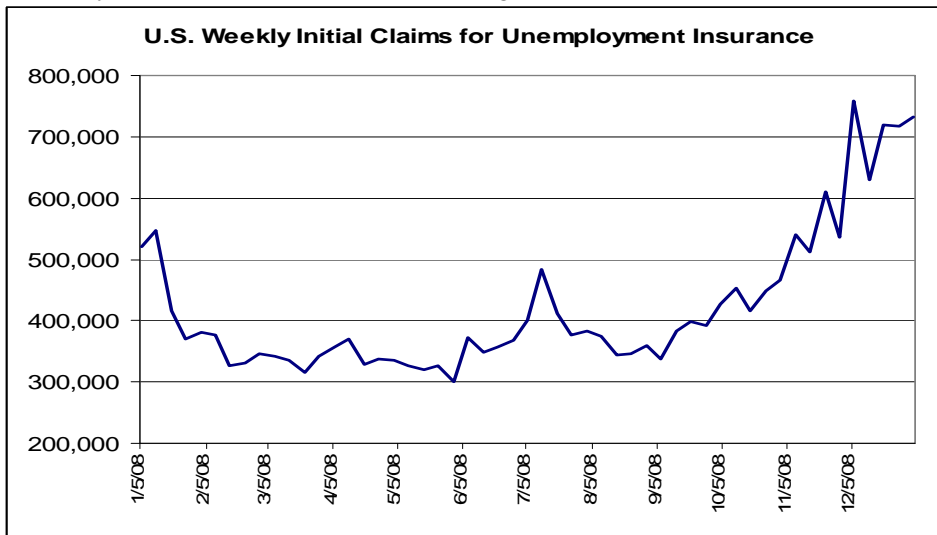
Some peers contend that the market is "cheap" at current levels. We agree that some stocks are more attractively valued now than in the past, but assert that price levels overall are not necessarily as inexpensive. Our bottom up analysis of earnings data has not found enough stability to be confident of valuation levels or catalysts for growth.

**Economic Data Confirms Still Weakening U.S. and Global Economies**

Data reported in January reflected an accelerating downturn in the U.S. and global economies. U.S. gross domestic product data for the fourth quarter fell 3.8%, which was above expectations that had called for a decline of over 5%. Inventory building that will likely take away from the GDP growth in the first quarter of 2009 was the reason for the smaller decline. Housing data continues to point to a long recovery from the excesses of recent years as seen in major declines in home prices. The S&P Case Shiller index for December declined 18.6%. Manufacturing data for December was also quite weak, with industrial production declining 2.0% and capacity utilization falling to 73.6%.

*The major story in the economy, however, is the employment situation. U.S. employment data for December showed payrolls declined 524,000 and over two million jobs lost in 2008. Sustained increases in layoffs will only exacerbate the length of time needed for the economy to recover. New claims for unemployment insurance show no improvement in the job market, as seen in the chart below.*

Although unemployment rates often peak after the economic data and stock markets begin to improve, the near-term outlook for the economy and consumer stocks remains negative.



Source: U.S. Department of Labor

**Investment Strategy Summary**

With earnings data and company guidance on profit levels still weakening, we continue to advocate patience and a cautious approach to the investment of available cash for portfolios. This view applies across the board for all types of investors, portfolios and asset types. For 401(k) investors, the key is to continue to keep contribution levels up if possible so that new dollars can be invested each month into the market to take advantage of lower prices. For new cash available to invest, averaging in over several months is prudent given the volatility of stock prices.

For portfolios that have been invested for some time, the use of cash balances for purchases in quality stocks at a patient pace makes good sense. Meanwhile, with the dramatic drop in interest rates, bond investors are advised to remain patient as many bond categories have seen price run-ups also above average. Select opportunities remain in municipal and corporate yields and we believe better investment opportunities in bonds will come as yields ultimately move back up.

*Christopher H. Lyford*

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Acadia Trust, N.A. is a Maine-based wealth management firm, with a distinctive approach based on our disciplined research process, value-oriented style of equity investing and our high quality approach to fixed income investing. As a trusted advisor to our clients, we provide portfolio management, trust, estate, financial planning and retirement plan services throughout New England.

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