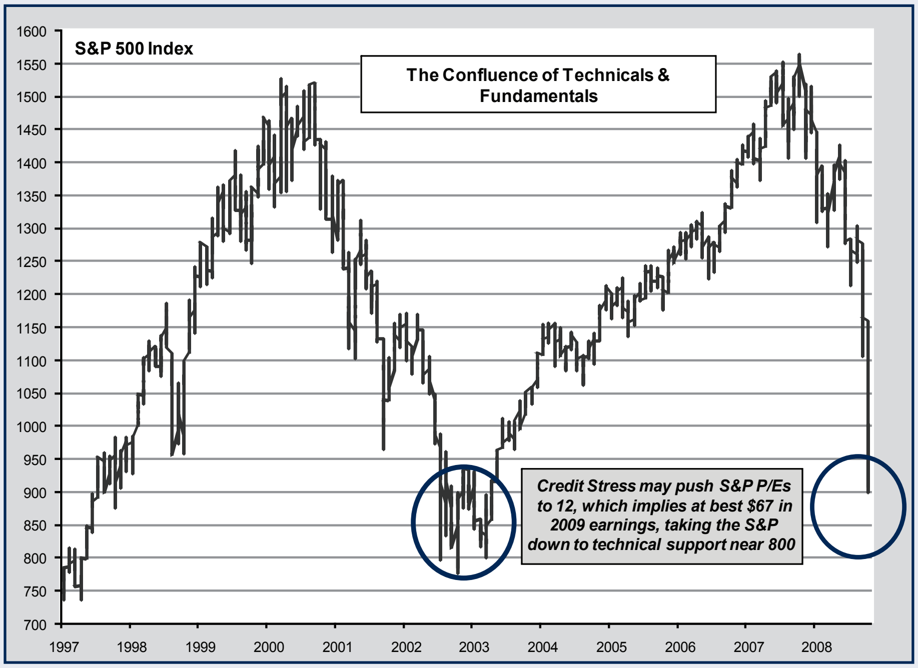
BULLSEYE Highlights

Panic P/Es

The markets are in the process of liquidation with lower lows interceded by strong rallies. Listening to the market takes constant effort, and sometimes we can learn from the distant past. Since July 1997 (Asian Crisis), default risk has been more of a concern to markets than inflation risk. Our awareness of prior Panics caused a swell of extreme discomfort in our target prices for a market low. The market's response to previous financial panics (1929, 1937, 1973 and 1981) can be very telling. Now, like then, we believe it's crucial to study charts and fundamentals. We analyzed past periods of extreme volatility and a protracted credit stress and found P/Es near 12 are the median for the S&P 500. Technical analysis is supported by fundamentals, with prices near 800 indicative of historic panic lows and in fulfillment of a Double Top (2000, 2007) & Bottom (2002, 2008/9?) price pattern. Many investors who learned from previous markets may view the market moving from 2007 Q3 peak earnings (S&P 1576/$85.11 = P/E 18.5) to a more sustainable P/E like at the October 10 low, where the market was pricing in 2009 earnings near $70 (S&P 839/ P/E 12).



For the charts above and below, the data and performance displayed represents past performance, which is no guarantee of future results.

A Historical Perspective

By studying history, perhaps we can learn how the market adjusts stock prices during times of crisis. Stock prices are decreasing to Panic P/E levels. Since 1873, there have been eight Panics prior to the 2008 Panic. During each Panic Period, trough P/Es ranged from 7 to 17 with medians ranging from 8 to 22. Median P/Es for each period are higher when there is CPI deflation and lowest with annualized inflation greater than 4.3%. The median and average of the lowest P/Es found during each period are both 11.

Valuation Points	Low P/E	Median P/E
1873 - 1877	11	14
1893 - 1896	17	22
1901 - 1903	13	14
1906 - 1907	9	13
1929 - 1932	11	19
1937 - 1938	10	14
1973 - 1974	7	12
1981 - 1982	8	8
Median	11	14
Average	11	14
2007 - ?	*12.5*	*20*

During our current Panic, the median P/E reported over the last 12 months is 20 while the Panic trough on October 10, 2008 was 12.5 (based upon the market's 2009 estimate of aggregate S&P earnings near $70). Over the next few months we would not be surprised to see the median P/E decline to or below 14 if the inflation rates creep higher than 4.3%. With the Cowles & Smith Composite Index prior to 1957 and S&P 500 Index thereafter, we reviewed 25 stock market declines. The median and average duration of all declines was 20 months while respective price troughs for these measures were -33% and -37%. The median and average P/Es for the duration of all declines were 14 and 15. Panic declines lasted longer (with a median of 29 months) and were more severe (-46%).

Low & Median P/Es During Panic Periods

25 Bear Markets (Blue = "*Panics*")

START	END	MONTHS	CHANGE	CPI Cumulative	P/Es
2/27/1873	**6/30/1877**	**52**	**-47%**	**-8.1%**	**14**
1/31/1893	**8/31/1896**	**43**	**-32%**	**-5.3%**	**22**
9/5/1899	9/24/1900	12	-32%	1.3%	14
1/12/1901	**11/9/1903**	**34**	**-46%**	**5.3%**	**14**
1/19/1906	**11/15/1907**	**22**	**-49%**	**8.4%**	**13**
11/19/1909	9/25/1911	22	-27%	2.1%	13
9/30/1912	7/30/1914	22	-24%	2.0%	14
11/21/1916	12/19/1917	13	-40%	23.4%	7
11/3/1919	8/24/1921	21	-47%	-4.3%	10
9/7/1929	**7/8/1932**	**34**	**-86%**	**-21.4%**	**19**
3/10/1937	**3/31/1938**	**12**	**-54%**	**-0.7%**	**14**
11/12/1938	4/8/1939	5	-26%	-1.4%	15
9/12/1939	4/28/1942	31	-43%	14.2%	9
5/29/1946	6/13/1949	37	-30%	29.3%	9
12/12/1961	6/26/1962	6	-28%	0.7%	18
2/9/1966	10/7/1966	8	-22%	2.4%	16
11/29/1968	5/26/1970	18	-36%	9.0%	16
1/11/1973	**12/6/1974**	**23**	**-46%**	**21.5%**	**12**
9/21/1976	3/6/1978	17	-20%	13.4%	9
4/27/1981	**8/12/1982**	**16**	**-24%**	**9.7%**	**8**
8/25/1987	10/19/1987	2	-33%	0.6%	20
7/16/1990	10/11/1990	3	-20%	2.2%	15
7/20/1998	10/8/1998	3	-21%	0.4%	28
9/1/2000	10/9/2002	24	-49%	4.1%	34
Total Median		**20**	**-33%**	**2.2%**	**14**
"Panics" Median		**29**	**-46%**	**2.3%**	**14**
Average		**20**	**-37%**	**4.5%**	**15**
10/9/2007	10/10/2008	12	**-43%**	**5.1%**	**17**

Panics of 1873, 1884, 1929 & 1937 (CPI Deflation); 1901, 1907, 1973 & 1981 (CPI Inflation).

Performance displayed represents past performance, which is no guarantee of future results.

Conclusion

To match medians and averages, the current Panic may not end until June 2009 or April 2010. Absent of an extreme downturn, we may be approaching a Double Bottom in a secular bear market that has existed since 2000. It is critical to long term performance that investors avoid market stampedes. Irrational exuberance turns to flight, flight to panic and panic can lead to outright disaster. Investors need to stay calm during Panic Periods and avoid getting swept up in group hysteria. Instead, they should make independent decisions that lead to profits, like buying when the crowd sells. Remember, financial markets are always shifting between greed and fear. Historically, a declining market has always come back, regardless of how shocking the events were that drove it down. When returning to the equity markets, investors should look for consistent gains and avoid the "home run" mentality. The investor's miracle is a steady compounded return over time. During Panic Periods investors should consider employing a buying strategy that falls within a price range. Don't make huge bets, instead scale in a portion (i.e., 20%) of investment capital today and allocate more if the market drives the price down again. Buying into the equity market at sensible multiples benefits the investor when the market ultimately returns.

Projecting the markets with P/Es - The worksheet below was designed to help estimate downside risk for the S&P 500 from a P/E perspective. Columns A, B, and C employ the following: the average earnings reported in the past 5 years (20 quarters), 12-month trailing reported earnings and operating estimates for 2009. The final column was provided to normalize the earnings estimate. The worksheet provides two P/E estimates and the corresponding changes in the S&P 500 from its high and low:

1) P/E of 12 which reflects panics or protracted recessions
2) P/E of 16 which reflects the mean since 1940

S&P Prices Based On P/Es:	Reported Earnings 5-yr Mean "A"	Reported Earnings 12-month "B"	Estimated 2009 Earnings "C"	Normalized Earnings A+B+C
S&P 500 Earnings Results	65.32	51.83	77.61	64.92
S&P 500 Price based on a PE of 12 (Panic P/E)	784	622	931	779
% Change from 10/10/08 Low (839.8)	-7%	-26%	11%	-7%
% Change from 10/11/07 High (1576.09)	-50%	-61%	-41%	-51%
S&P 500 Price based on a PE of 16 (Historic Avg since 1940)	1045	829	1242	1039
% Change from 10/10/08 Low (839.8)	24%	-1%	48%	24%
% Change from 10/11/07 High (1576.09)	-34%	-47%	-21%	-34%

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