

KRAEMER, SCHWAB & CO. AG
Investment Management

MARKET COMMENTS MID-YEAR 2008

"Rejoice when markets decline"

While most investors are familiar with Warren Buffett's advice to "rejoice when markets decline," many have a hard time putting it into practice.

Negative to catastrophic news continues to flow in daily and suppress any positive developments. High energy, raw material and food prices squeeze the average consumer. An endless downside spiral in real estate and financial markets seems to be in process, resulting in staggering losses. It brings to light many questionable, hard to understand practices and behaviours and reinforces the impression that a sick and disintegrating world is on the fringes of an abyss.

These are very tough times for the unsuspecting investor. When he talks to friends to find consolation in an unpleasant and worrying situation, they will not fail to mention casually that they sold all their stocks in the autumn of 2007 and are now preserving their savings in cash. They will add that they wouldn't be able to cope with the steadily shrinking values, which the present bear market would force on them. If the discussion turns to specific companies, their dire situations and how dramatic their fall has been, the acquaintance may add with self-satisfaction that luckily he doesn't own these stocks, while you take a deep breath and suffer silently.

When I look for similar situations in the past, the autumn of 2002 comes to mind. In 2001 Argentina had gone bankrupt. All eyes then turned to Brazil. When elections in 2002 were won by Socialist Lula da Silva, the world expected the country sooner or later to stop paying its debts. Interest rates on Brazilian papers shot up to over 20%, prices plunged and there were practically no takers. We analyzed the situation and decided to sit tight, maybe to add occasionally a few bonds. While placing an order one felt almost obliged to apologize and declare to the counterparty that one was not crazy. Six years later it turns out that these bonds have been a rare chance to earn an exceptional return.

In 1997 Asian emerging countries suffered an economic and financial setback that spread also to Russia and South America. Stock and bond prices collapsed and there seemed to be no future and no tomorrow. Many investment funds closed and liquidated after heavy withdrawals, others shrank in size to a fraction of their original size. Disappointment and disillusionment had replaced earlier excessive enthusiasm. Whoever dared to invest during this time of despair had to be very patient, but he has reaped big profits in the following ten years.

We could continue this list with earlier downturns and disasters and the upswings that followed them. During a crisis, as prices drop without any end in sight, it is extremely tough to believe that they have to and will stop falling and that the most rewarding purchases will be made during such times. Market sentiment can be very confounding and depressing for investors. In the end worry and panic overwhelm recognition of the fantastic opportunities offered by low valuation, high dividend yields and high earnings power. Anybody who wants to build his wealth has to stay the course in this storm.

Lew Sanders of Alliance Bernstein once said, an investor can make a lot of money if he is prepared to live for some time feeling depressed, isolated and afraid, waiting for the market to revert to a normal valuation from a state of high anxiety. This is what is happening to us at the moment. But the reward is higher wealth, comfort and financial safety. It is well worth the temporary inconvenience and hardship.

Roland Schwab

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