AMERICAN FINANCIAL ADVISORS, LLC

Market Commentary 4th Quarter 2008

We Have Been Here Before

As we head into 2009, we are still in a period of time where calm, rational guidance is appreciated and necessary and we know challenges are still ahead. A few statements of direct, truthful observations are appropriate at this juncture.

(1) We did not foresee the steep decline in prices and valuations that occurred. A "normal" correction of 15-20 % was understandable after the past five years of a bull since 2002. But the additional 15-30% that many markets have dropped on the heels of the housing debacle, credit crisis, and meltdown on Wall Street was very tough to know in advance.

(2) A diversified portfolio of stocks/bonds/cash will serve our clients well who remain disciplined and do not capitulate out of the market at the worst possible time. 99% of our clients do not need 99% of their money anytime soon. The global economy is resilient and will continue to grow. America will remain a key player in all respects, including higher valuations in the markets.

(3) Market timers are not any smarter either, as they like to claim -- or their clients would be much wealthier than they are. They end up being out of the market at key times and their total returns are well documented as suffering in the long run. The latest DALBAR study once again concluded that investors who remained in the market over the past 20 years averaged 7% higher annual returns than market timers and those who buy/sell often.

(4) Books will be written about the current market crisis in housing, stocks and bonds. Sound investment advice is of little use if you don't follow it and are miserable due to anxiety over the performance of your portfolio. Investing in the stock market and real estate should be viewed as a marathon, not a sprint. These investments are for long term investors. The recent decline in prices underscores the risks, but that doesn't mean the world is coming to an end. We have been here before.

We would like to focus on a few additional questions:

First: *Should you bail out of the stock market?*

The straight answer is "NO". Admittedly, past performance is no guarantee of future results and the past may or may not repeat. Let's look at the last 50 years. Excluding the current bear market, we have had other periods in which the market has fallen more than 20% from its peak. The average decline has been 32% and lasted 18 months.

Compared to the average decline of 32%, the S&P 500 is down over 40% since its peak on 10/9/2007. There have only been two out of nine bear markets that have been "grizzlier" than this one. One occurred from 1973 to October 1974 when the market fell 48%. The other, which you may remember, was a 49% fall from March of 2000 to October of 2002.

Looking at historical comparisons, we are much closer to the bottom than we are to the top. Recent news says we have been in a recession for a year. Many say the market is cheap here – with prices at 10-year lows, but fear is still keeping many investors on the sidelines. We are reviewing the entire landscape and the re-pricing of all assets that has occurred. Thus, we are making changes in the model portfolios – to take advantage of what the markets are offering.

Second: *Are we headed for a depression?*

No, we do not believe this is the case. The worst market declines occurred during the "Depression" in the 1930's. Our fiscal and monetary policies and our regulatory systems are much different now. We are not on a gold standard, so the government can easily create money.

During the Depression the U.S. government did not stimulate the economy; it allowed contraction. The current Fed, Congress and President Elect Obama are supporting and enacting significant economic stimulus. Since inflation is not a concern now – this can and will be done.

Markets tend to bounce back quickly after reaching bottom, so being out of the market exposes you to the risk of missing a significant recovery. Following the previous bear markets over the last 50 years, on average, the market was up 23% six months after hitting bottom with 11% of that rise coming in the first month. Three months after the bottom, the average is 15%.

It is useful to understand why free markets work because doing so simultaneously helps us understand their weaknesses. Market expansions are much longer and profitable than contractions – but you won't win if you don't have any money on the table and accept the risk.

Third: *Is the market making a mistake? Do stock prices appear too high or too low, given all we know about the economy and profits?*

In our view, the crowd has panicked. It has been wrong before and the pendulum tends to swing too far in both directions – both positive and negative. Let's start with the economy. Despite failures of large institutions, current job losses, the credit crisis, excessive risk on Wall Street, and general negative attitude across the board – there are very good opportunities in the markets right now.

The Fed and the government are doing what is necessary to avoid a deeper recession and jump start the economy. Also, the important positive news includes the stronger dollar and lower energy prices, which are being completely ignored.

The broad market's intraday price action over the past couple months has been volatile and obviously indecisive. This tug of war between highs/lows on any given day can be the sign of a "bottom". Throughout October and November, stocks rallied in the early afternoon, then nosedived into the close.

More recently, the broad market displayed the inverse pattern. Further, despite the large selloff on Dec. 1, the S&P and Dow have closed higher in seven of the last eight sessions in the first week of December and has had moderate shifts so far in January. While it's still too early to know whether the recent rally attempt will get legs, traders are noticing the start of a possible change in overall sentiment.

That said, we can take advantage of the 50-year lows on corporate bonds and attractive dividends to get paid for waiting, while the stock market continues to digest all the negative news. The dividend yield on stocks is now higher than the yield on 10-year Treasuries, which provides advantages for both yield and eventual appreciation of principal for those same high quality dividend paying companies. Interesting to note, we think the next bubble could be in U.S. Treasuries – the one place investors think they are safe, but whose prices are now historically very expensive – with no yield.

In closing, we know it is cliché to say this and it doesn't "fix" the current decline in overall values – but we haven't "lost" anything if we don't capitulate and remain patient. There is no reason to believe the same diversified investments that took us to previous highs won't do so again, especially as we adjust the portfolio models to take advantage of extreme price declines that defy logic and the underlying fundamentals of a global economy and marketplace that will continue to expand and grow, not shrink.