

Rebuilding After the Storm: Perspectives on the 2007-08 Bear Market








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Key Points to Remember

-  Time: Many stocks started major downtrends almost 2 years ago
 - Peak in breadth was mid 2007
-  Magnitude: S&P 500 dropped 45% high to low
 - On par with the biggest declines in market history
-  Valuation: Value Line price/earnings ratio is 10 (November 2008)
 - Reached about 20 in 2001
 - March 2003 low was 14
 - December 1974 it reached a low of 5
-  Fear: reached extremes in November 2008
 - Sentiment measures, VIX (volatility index)
-  Credit spreads are high
 - Fear of owning even high quality corporate bonds

The Big Picture

All the ingredients that have marked previous major bottoms are in place.

It may just be a waiting game for stocks to improve.

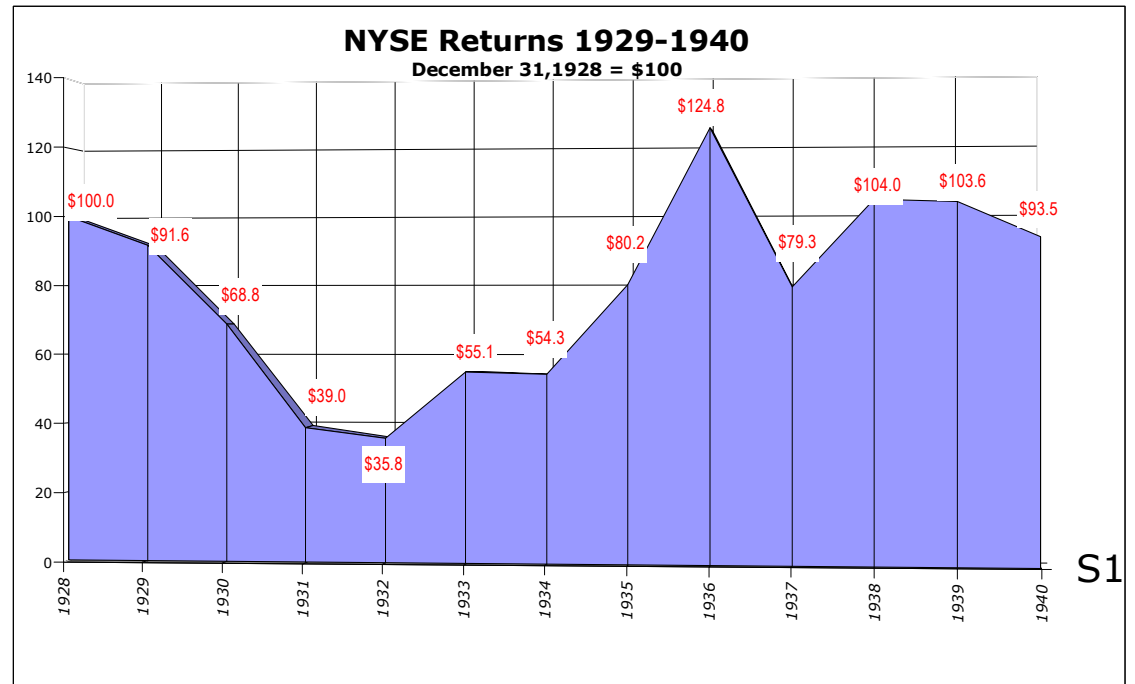
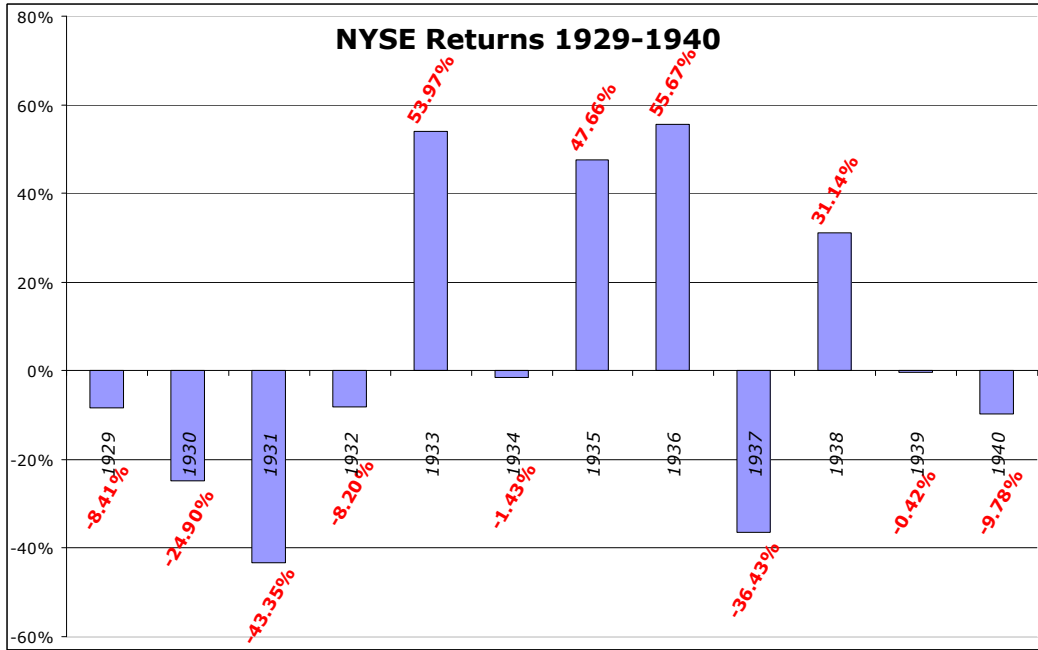
Equities



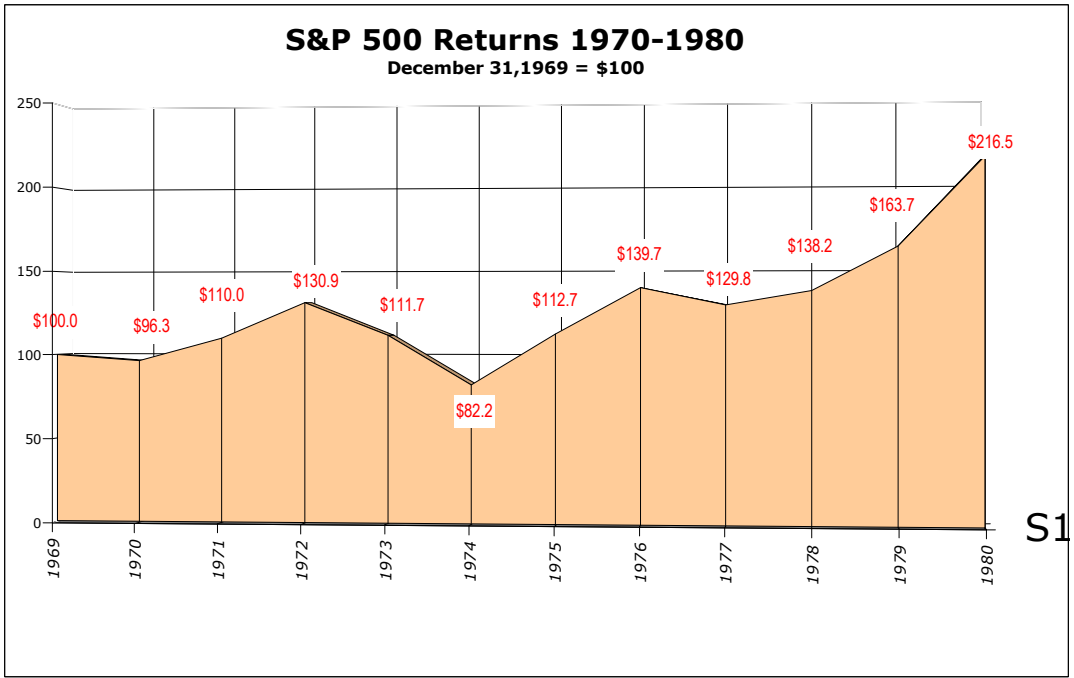
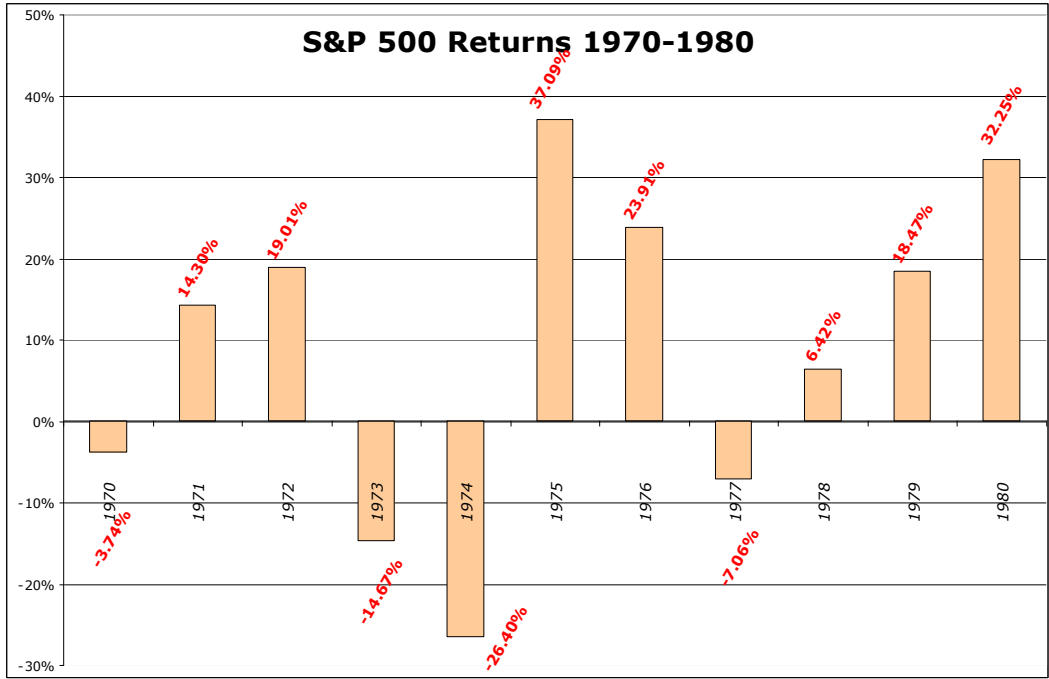
Source: Standard & Poor's, First Call, Compustat, FactSet, JPMorgan Asset Management.

Trailing P/E ratios for the S&P 500 Index are top-down values which reflect the index month-end price divided by the last twelve months' earnings, as provided by Compustat/Standard & Poor's, which is calculated by summing four quarters of available earnings data. There is an inherent lag in the reporting of this data by companies to S&P. As such, historical data can change as new information becomes available.

Forward P/E is based on a bottom-up calculation using analyst operating estimates from First Call on a next twelve months' basis and are calculated using a harmonic weighted average. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future results. Data are as of 12/31/08.

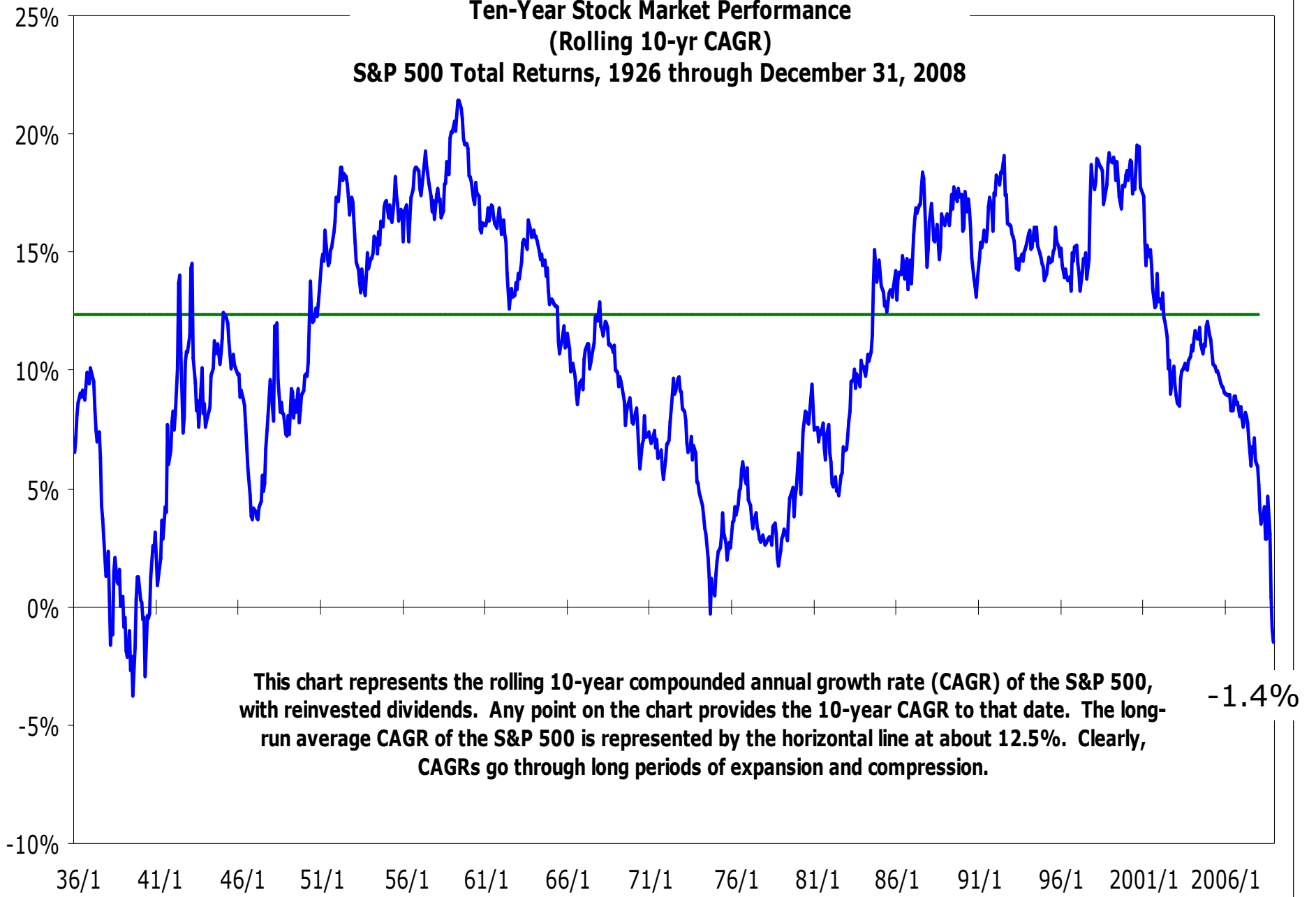


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**Ten-Year Stock Market Performance
(Rolling 10-yr CAGR)
S&P 500 Total Returns, 1926 through December 31, 2008**



The Q-Ratio

Updated Dec. 12, 2008

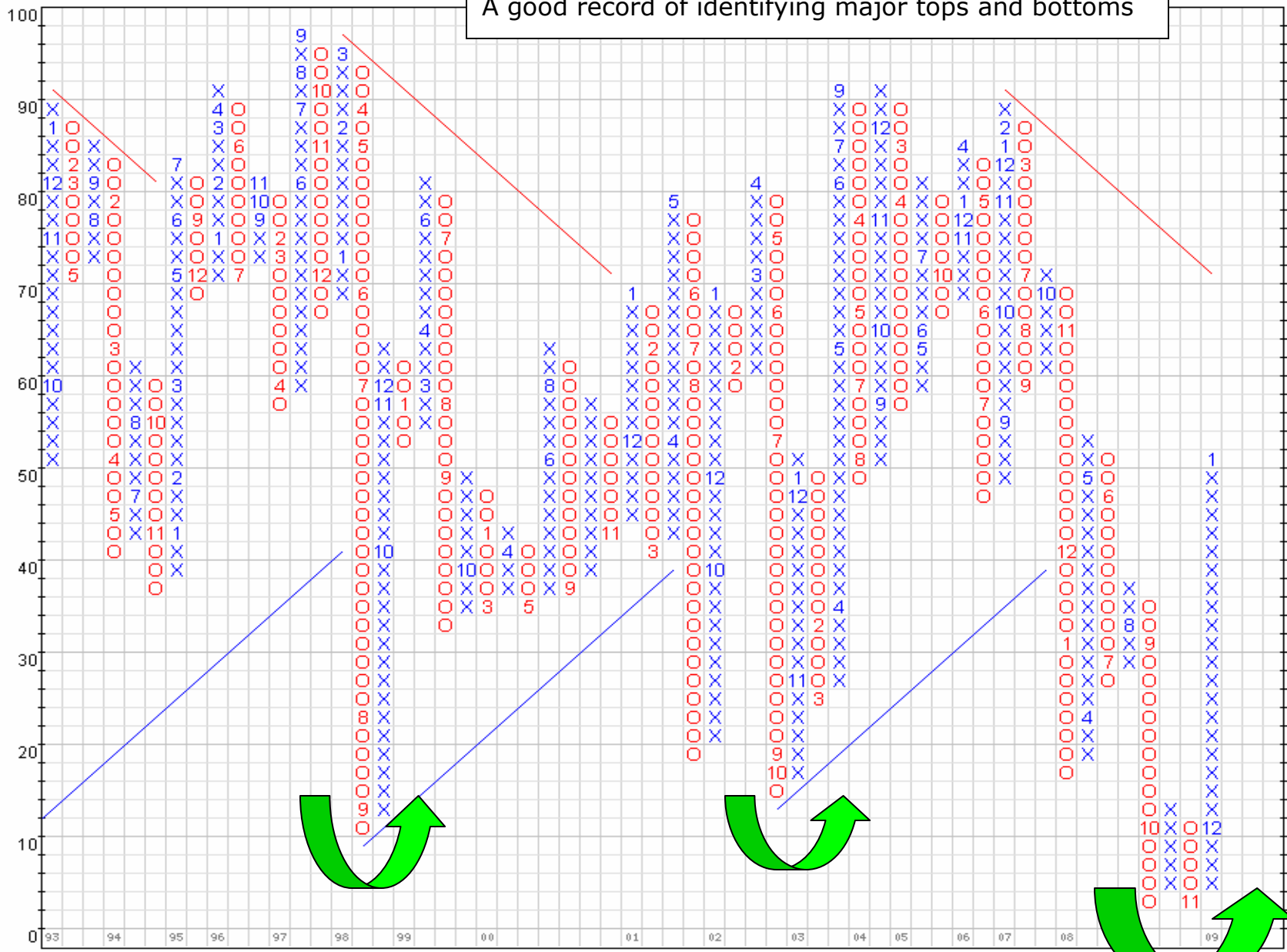


Q is a method of estimating the fair value of the stock market. It's defined as the total price of the market divided by the replacement cost of all its companies. The concept was originally developed by economist James Tobin. More recently, it's been advocated by Andrew Smithers and Stephen Wright in their prescient book [Valuing Wall Street](#).

Source: Federal Reserve, JPMorgan Asset Management. Data reflects estimated levels as of the end of 3Q08 and represents the stock market value divided by net asset value of non-financial corporations, multiplied by 100. (Note that the Federal Reserve does not calculate this ratio for financial firms).



A good record of identifying major tops and bottoms

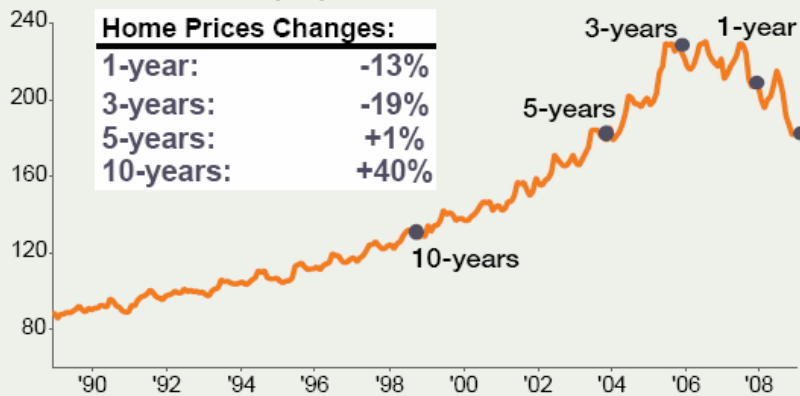


The Aftermath of the Housing Bubble

Economy

Median Home Prices

Thousands, non-seasonally adjusted



Unsold New Homes

Thousands, seasonally adjusted



Housing Starts

Thousands, seasonally adjusted annual rate



Mortgage Payment on Average New Home

% of average household personal income



Source: Census Bureau, FactSet, EcoWin, JPMorgan Asset Management.

Data reflects most recently available as of 12/31/08.

Home price based on median sales price of existing homes and are cumulative, not annualized. Existing-home sales include single-family, townhomes, condominiums and co-ops.

Source: (top chart) Census Bureau, FactSet, EcoWin, JPMorgan Asset Management.

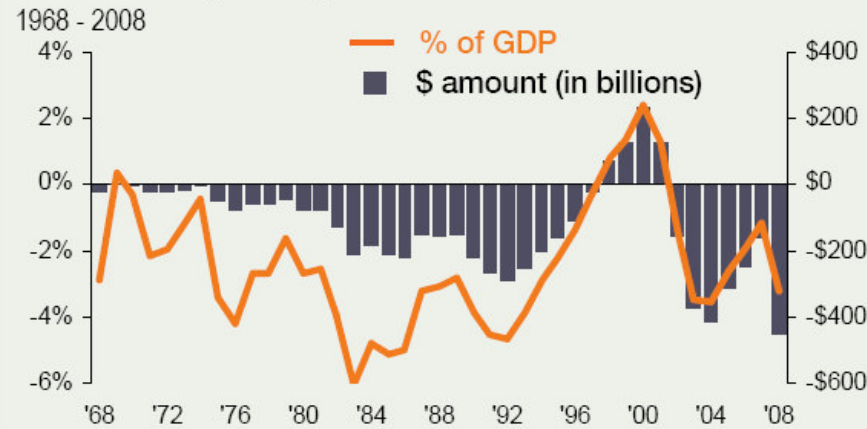
Source: (bottom chart) Census Bureau, Federal Reserve Board, BEA, JPMorgan Asset Management.

Data reflects most recently available as of 12/31/08.



Economy

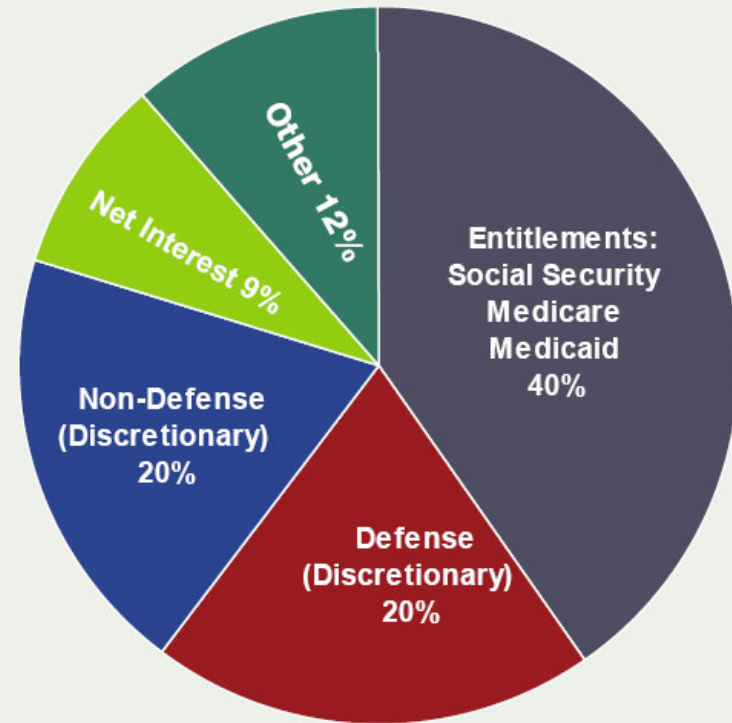
Federal Budget Surplus/Deficit



Federal Debt (Accumulated Deficits)



U.S. Federal Budget Outlays 2008



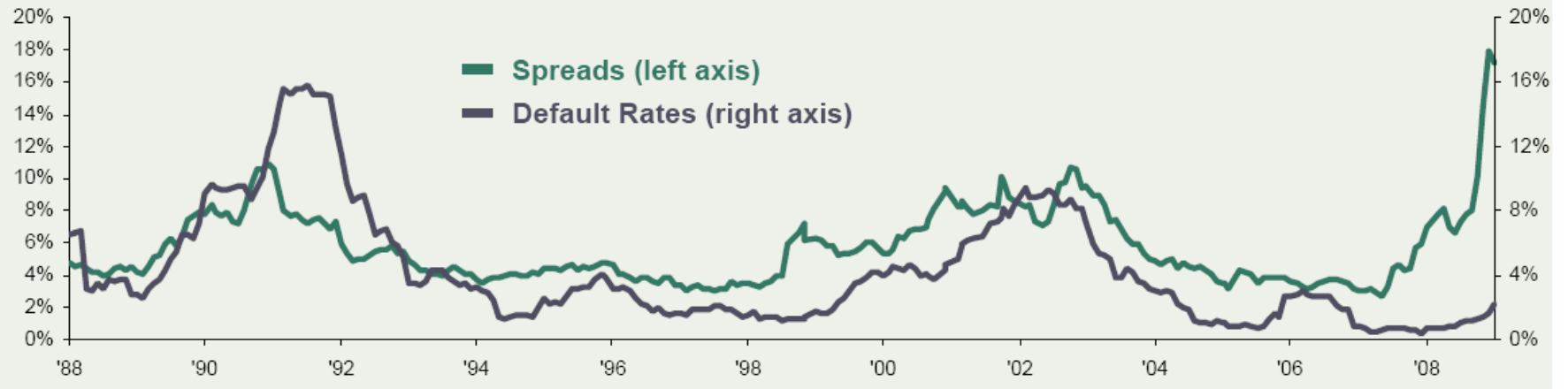
Total Actual 2008 Budget Receipts: \$2,524 billion
 Total Actual 2008 Budget Outlays: \$2,979 billion
Actual Surplus / Deficit: -\$455 billion

Source: Congressional Budget Office, St. Louis Fed, Bureau of Economic Analysis, JPMorgan Asset Management. Data reflects most recently available as of 12/31/08.

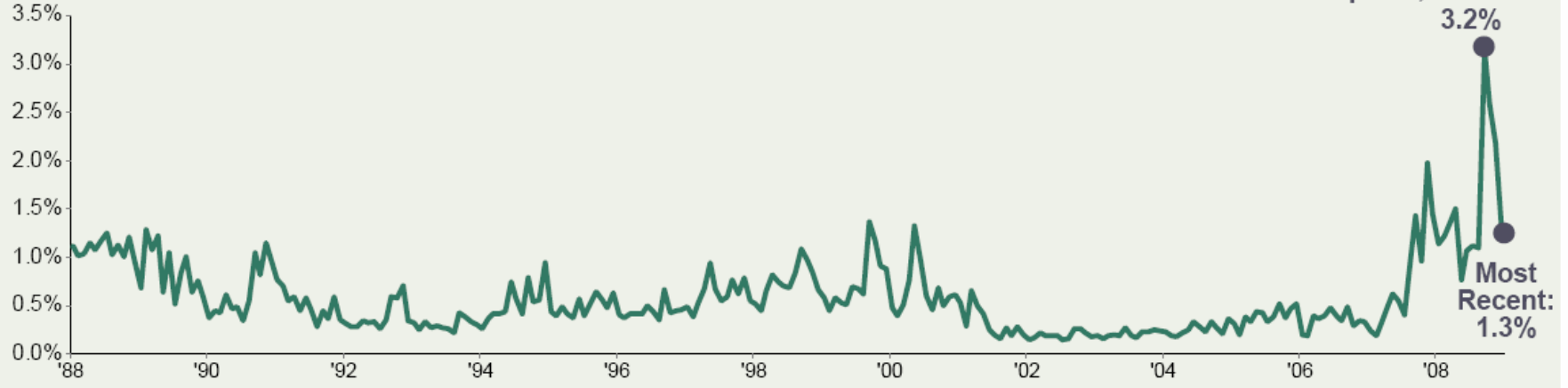
Source: Congressional Budget Office, JPMorgan Asset Management.

Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Top right chart displays federal debt in the hands of the public.

High Yield Spreads vs. High Yield Default Rates



LIBOR Spread over Treasuries (3-month maturities)



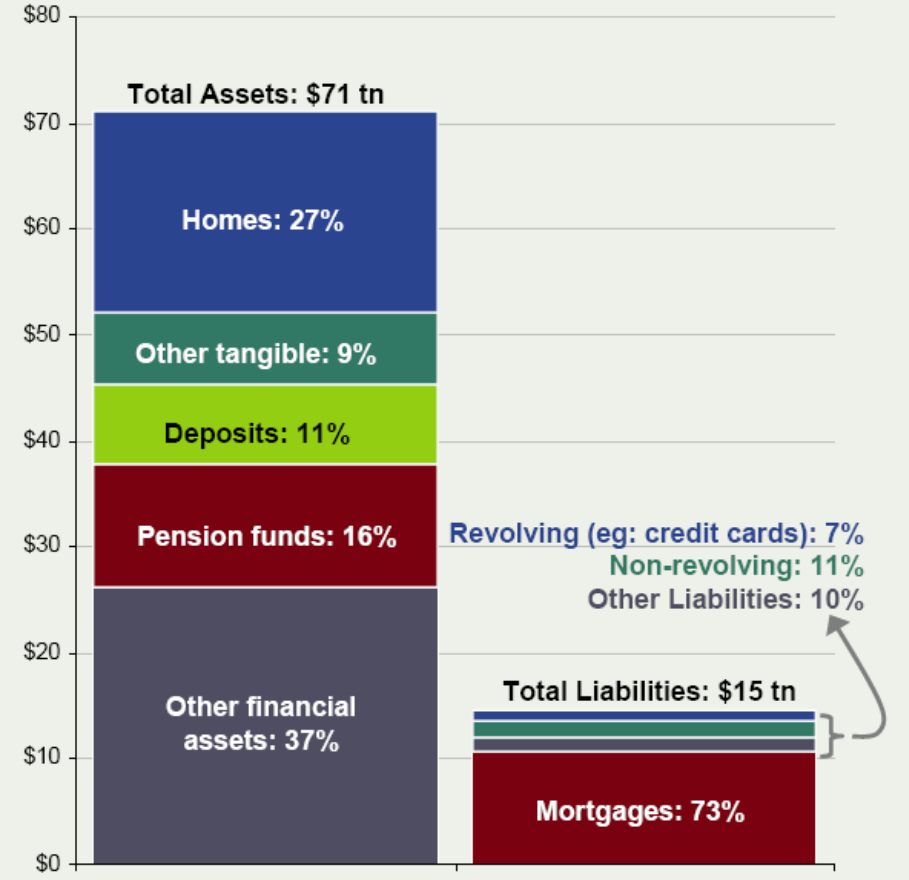
Source: British Bankers Association, U.S. Treasury, Reuters, EcoWin, JPMorgan Asset Management, FactSet.

High yield spreads are yield to worst over comparable Treasury yields. Data are as of 12/31/08.

Economy

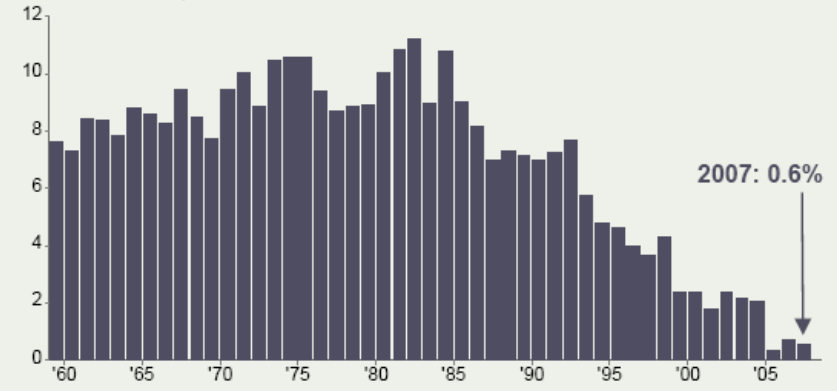
Consumer Balance Sheet

Trillions of dollars outstanding, not seasonally adjusted



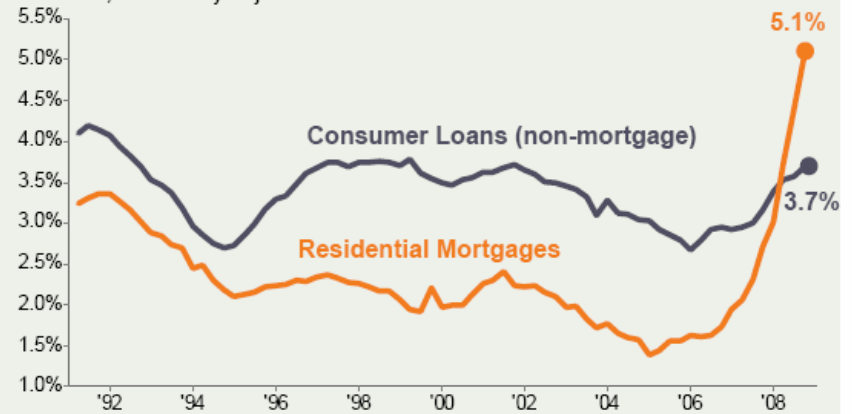
Personal Savings Rate

Annual, % of disposable income



Delinquency Rates

All banks, seasonally adjusted



Source: (Left chart) JPMorgan Asset Management, Federal Reserve. Data includes households and nonprofit organizations. (Right charts) JPMorgan Asset Management, BEA, Federal Reserve.

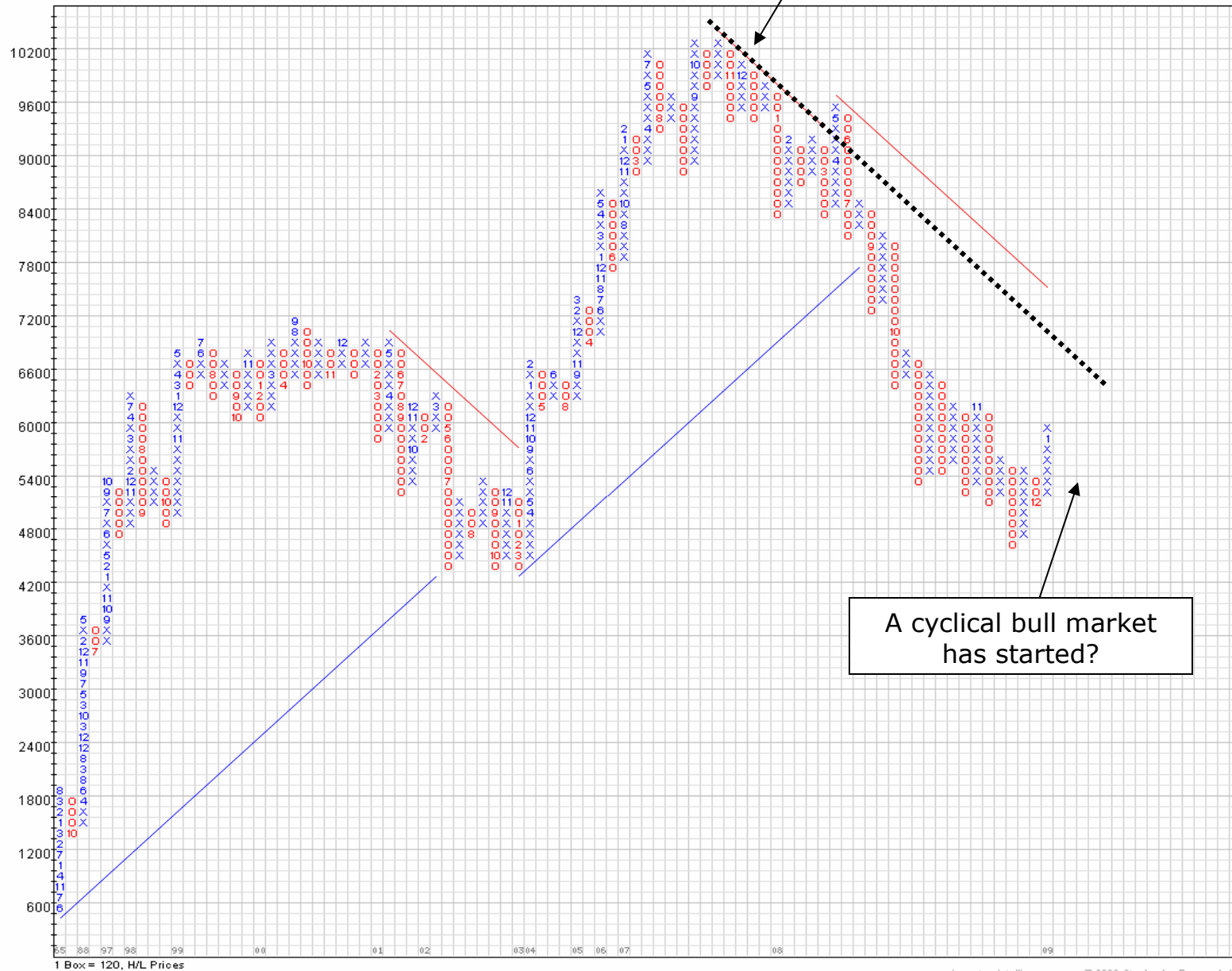
Personal savings rate is calculated as personal savings (after-tax income – personal outlays) divided by after-tax income. Employer and employee contributions to retirement funds are included in after-tax income but not in personal outlays, and thus are implicitly included in personal savings.

Data are as of 3Q08.

Biggest Technical Challenge—Getting Through the Major Resistance Line

NYSE Composite (NYA) 5799.05 -169.79

7 Jan 2009



A cyclical bull market has started?