



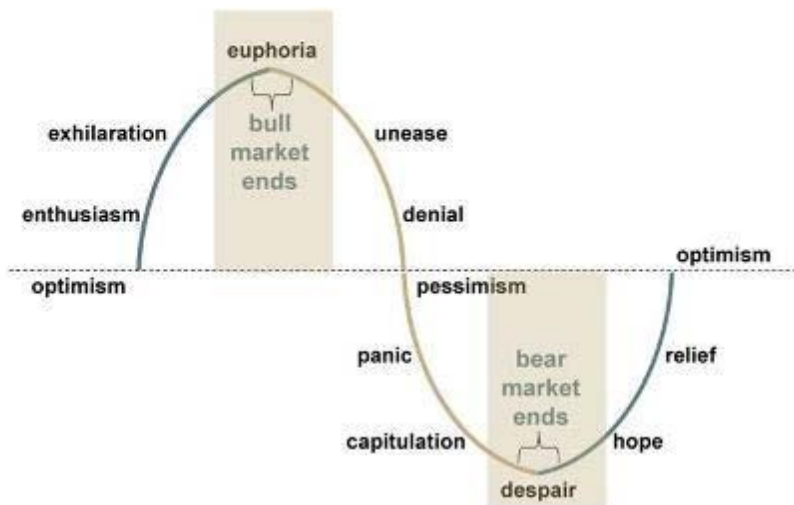
Graphing the Emotional Roller Coaster

If you were to graph the performance of the US stock market over the last ten years, you'd be looking at something that looked a lot like a roller coaster: a steep climb 1998-2000, a sharp drop 2000-2002, a steady rise to October 2007's peak, a big decline January through August 2008, and finally, a stomach-lurching drop in September and October.

As stock prices go, so can investors' emotions. The image below, published by Charles Schwab & Co., may be of some help in understanding that rising and falling stock prices can take us, as investors, on an emotional roller coaster ride from euphoria to despair.

Market's emotional roller coaster

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In a rising market, we feel optimistic. We get more than optimistic as prices keep rising - we get exhilarated, and are euphoric at the top. Anybody recognize that feeling? Or remember it, from 1999, for example? That's the peak of the cycle: "irrational exuberance" as Alan Greenspan so famously put it.

As prices begin to drop, we feel unease. They drop further, generating denial, and then pessimism. The drop lengthens and continues, generating panic over the losses. At capitulation, investors throw in the towel, and sell. And finally, at the bottom, there is despair. I am sure all of us have felt some of these emotions over the last three months; this bear market has been vicious.

After the bottom, prices start to improve. Then there are sparks of hope. Prices continue to climb, and we feel relief. The bull market strengthens, and lengthens, until we're back to optimism, where we started.

It's impossible to know whether this bear market is nearing a bottom or at a bottom. Nonetheless, we should recognize that at the bottom, behavior and sentiment will be very negative. For example:

- Consumer sentiment (surveys measuring consumer optimism or pessimism about the economy) will be very low,
- Volatility indexes (measurements of the expected volatility of the stock market over the next 30 days) will be high, and
- Mutual fund redemptions (shareholders bailing out of stock mutual funds) will reach their peak

As in life, the darkest hour is just before dawn. We won't know when we've reached that hour until long after the recovery starts. By recognizing that negative emotions are part of the market cycle, however, we have some ammunition for resisting acting upon those emotions, and looking forward to brighter days.

--Joe Hebert. Posted 11/17/08.