SARA-BAY FINANCIAL CORP.

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Adversity and Opportunity – Synonyms?

Years ago, I came across a statement that claimed the Chinese had a word for adversity which was synonymous with opportunity. Upon digging a little deeper, I must admit to finding no evidence of a word having those precise meanings when translated to English. As my abilities to speak or read Chinese are somewhat limited, I may stand to be corrected on this score. Notwithstanding, an important truth to be considered is this: Thorny financial difficulties always lead to renewed efforts in attacking our problems, and solutions are found. In due course, the mythical Phoenix does arise from its own ashes and starts a deliberate, but steady climb. A study of history proves that our country has done this again and again.

This time is NOT different! We have said this before, but it bears repeating, since at least a dozen friends and clients have stated, in effect, that our nation has never seen a financial crisis like this before. We do not accept this. Similar financial turmoil visits our country every thirty or forty years, and sometimes more frequently. They are so far apart that we have either forgotten them, or if we do recall them, our personal circumstances were very different. They are always caused by debt, and while not exact repetitions, the patterns are similar. Large groups of people go on a spending binge and borrow the money to do so. They feel prosperous for a while as prices climb, and lenders eagerly feed the frenzy. Then, unexpectedly, and quite suddenly, the boom ends. Prices stop rising, falter, and then begin a descent. As values continue to drop, the once happy borrowers lose more than they ever thought possible and formerly eager lenders become frozen in fear. We all suffer from the resulting hangover.

While we believe our current situation is more analogous to the 45% drop in the Dow that started in 1973 and ended December, 1974, let us consider 1932. Prior to the decline, both consumer debt and margin debt had risen sharply, starting in mid-20s and continuing through early 1929. Margin requirements to buy stock were as low as 10%, which meant an investor could buy $100,000 worth of stock and borrow $90,000 of the purchase price from his broker or bank. We all know the story of the resulting plunge in prices when the bubble ended.

By 1932 the economic news was far worse than today. Unemployment hit a high of 25% and the newspapers reported the outlook was indeed very gloomy. The stock market had fallen to extremely low levels, and pessimism was rampant. A new president was inaugurated, and he shortly began to spend money our country did not have. Does this sound familiar? Over the next few years he created the CCC (Civilian Conservation Corps - 1933) and the WPA (Works Project Administration – 1935). The great Depression lasted through the decade of the 30s, but in 1932 during the depths of despair, the stock market quietly hit bottom and the Dow began to rise. Over the next five years, from 1932 to 1937, it gained almost 500%.

There is no question concerning the continuing flow of bad news and poor earnings streaming from the media these days. We expect this trend to continue for some time. When the stock market does finally hit bottom, and we believe that time is near, no one will

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be ringing a bell or declaring it from rooftops. Instead, share prices of solid companies will, without fanfare, begin to rise and climb a wall of worry.

Our economy has not stopped; merely slowed. People are still buying food, clothes, paying the electric bills, taking vacations, and the vast majority of those who have mortgages are continuing pay them. Money has not disappeared. There is more money today in money market funds than in stock mutual funds. The economic stimulus plan is planning to send more on the way. We believe this plan will eventually be inflationary, but that is a topic for another letter. The point is there is a lot of cash on the sidelines, and people will soon tire of earning less than 2 percent and then paying tax on it.

One of the greatest benefits I have found from the investment business is that we come in contact with some very astute people who study the stock market and our financial system in great detail. These are folks with whom we can exchange and discuss ideas, and from whom we can learn. Three people immediately come to mind, and none of them are directly connected with the financial business. One of these bright individuals came up with the following theory years ago, and it has repeatedly proven both accurate and effective. It is simply this: "**Markets generally go up when business is bad, deteriorating, or not significantly improving."**

Waiting for the news to get better is not the right strategy. When that happens, we will already be in the ninth inning (of the next advance). Opportunities present themselves to all, but only the small minority has the ability to wade through the bombardment of bad news, avail themselves of the opportunities, and thus reap the rewards.

Sincerely,

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