



Market BULLETIN

January 2008 Market Bulletin

Dear Commerce Trust Client:

Where there is volatility, there is often opportunity. We at The Commerce Trust Company recognize the recent market sell-off coupled with the sub-prime loan debacle has investors on edge as we enter the new year. Despite market declines of about 10% for 2008, we believe plenty of opportunity remains for investors during this period of instability.

How can this be possible when the mass media is full of references to recessions and bear markets for the first time in five years? If a simple definition of recession is two consecutive quarters of negative growth combined with a significant drop in employment, then there is certainly a realistic chance for a recession if we are not in one already. Given that the average U.S. recession lasts 10 months, however, economists may diagnose the disease about the time the patient actually recovers.

We at Commerce Trust believe it is important to be prepared for the expected return to health of the U.S. economy by year's end. While the economic news will not be very pleasant this quarter, we remain optimistic about the economy overall and enthusiastic over practical steps to take to mitigate this downturn. This is the time to review your portfolio's health when investor sentiment is negative, while valuation levels are attractive and interest rates are falling. We especially feel positive about equities over the long term. Remember the equity market is a *leading* indicator and the market moves well *before* the economic news improves. We believe by the second half of the year the outlook for the economy will be better and stock prices will already have moved higher.

The stock market declines have been led by financial institutions, which developed a herd mentality with regards to their involvement with sub-prime mortgage investment products. When the disease of poor underwriting infected the product, it spread like wildfire, resulting in large write-offs for the big brokerage firms and negatively impacting the financial well-being of those firms. (At Commerce, our traditionally conservative stance in underwriting loans has kept us out of sub-prime loan and investment trouble.)

In China, where relative market prosperity continues, the word "crisis" is symbolized by the unique combination of the characters for "danger" and "opportunity." Like the Chinese, we believe that volatility creates opportunity in the market place. This is a time to reassess your portfolio with your Commerce Trust portfolio managers. While no one can time the market as far as picking a low and a high, all of us have the ability to check our individual portfolio's vital signs.

A time-proven way to do this is to check if the asset classes of our respective portfolios have shifted out of balance during recent volatility. Re-balancing our

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portfolios is a healthy way to restore stability. On a regular basis investors should review the asset class composition of their portfolio. Over time, exposure to certain asset classes can build up and lead to the need to rebalance one's portfolio. Left unchecked, a portfolio can move out of alignment, resulting in greater (or less) risk than desired. When asset classes become overweighted relative to their target, rebalancing to underweighted asset classes can get the portfolio back into alignment.

The healthy underpinning to this approach is that you can benefit from the effects of dollar-cost-averaging*, another proven technique to deal with market adversity. One buys back into the market in incremental portions as the market declines. For our clients currently on the sidelines with cash or with an overweight in fixed income, we encourage them to "dollar-cost-average" their way efficiently back into the market where appropriate. A Commerce portfolio manager can help you make decisions on equities poised for a rebound.

The message is the same in any historical downturn in the U.S. markets – namely, to take the emotion out of your decisions by focusing on quality issues and staying invested in the market. With a properly allocated and diversified portfolio, investors can be poised for the rebound. We at Commerce believe Large-Cap Growth stocks will outperform Large-Cap Value stocks during this period. Combined with proper allocations in international and emerging stocks, investors can reduce risk and participate in upward movement forecast toward the end of the year.

On the fixed income side of the fence, opportunities are also the rule during volatility. Corporate financial performance is expected to decelerate as the economy weakens; however, yield spreads for investment grade corporate bonds in many cases provide adequate compensation. Currently, spreads for high quality bonds and municipals are well above their historic average, resulting in attractive opportunities for bond investors.

In response to the concerns about a weakening economy and turmoil in the financial markets, the Federal Reserve recently made an inter-meeting cut of three-quarters of a percentage point. On January 22nd, the Fed lowered its federal funds rate to 3.5 percent from 4.25 percent prior to their scheduled January 30th meeting. This was the biggest rate cut by the Fed since October 1984, and the first cut between regularly scheduled meetings since a half-point cut on the day the market reopened following the September 2001 terrorist attacks. We believe the Federal Open Market Committee will continue to lower the funds rate further. In recent testimony to Congress, Fed Chairman Ben Bernanke told Congress that legislators should enact a fiscal stimulus package in order to help consumers as recession fears grow. A two-pronged attack (i.e., lower interest rates and fiscal stimulus) may be needed to avoid a recession.

Volatility will continue as the market probes for a low point. But even with the slowdown, opportunities will remain in the market. If you would like to speak with your Commerce Trust advisor anytime during this period of volatility, we welcome the call. *Come to Commerce for advice you can trust.*

The Commerce Trust Company Investment Policy Committee

**Dollar cost averaging is a technique designed to reduce market risk through the systematic purchase of securities at predetermined intervals and set amounts.*



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