HANOVER ADVISORS INCORPORATED

INVESTMENT COMMENTARY

PROVIDING INVESTMENT ADVICE SINCE 1989

Selected By WEALTH MANAGER Magazine As One Of America's Top 500 Advisory Firms

OCTOBER 20, 2008

Stephen Molyneaux

"OUR FAVORITE HOLDING PERIOD IS FOREVER"

-Warren Buffet

Keeping the correct perspective when the stock market is getting bludgeoned day after day with five, or six hundred point losses is easier said than done. The previous quarter was difficult enough, but these past few weeks have tested even the most iron-willed of investors. A herd-like mentality of fear developed and engulfed investors worldwide setting off a stampede of selling. An endless news cycle proclaiming, "crisis," "collapse," "plunge," and showing historical footage of the Great Depression has only helped to fuel the panic-driven selling frenzy. Panics are based on emotion, and emotions can take on a life of their own. The recent credit crisis shook investor confidence to its core and resulted in many investors acting solely on emotions. While the economy is weak and the next few business quarters may be difficult, there is little empirical evidence that would justify the panic selling observed recently. Panics and downturns are all part of our free market system. They have occurred throughout history and they will occur again. Sudden, sharp downturns should be recognized as being part of a cycle that usually punctuates years of slow and steady growth. Historically, bear markets and panics are relatively brief when compared to the duration of bull markets. Also, historical cyclical market downturns have been connected to credit excesses - this time is no different. Consider some of the following historical facts regarding bear and bull markets:

- *In January of 1970, a bear market started that lasted until May, 1970. The market during that time fell 35.4%. In May, a bull market began that lasted until January, 1973 and resulted in a 124% gain in stock values.*

- *In April of 1981, another bear market commenced that lasted nearly a year and brought a 24.7% decline. In March of 1982, the market began to rise and continued doing so until June 1983, bringing an overall return of 71.7%.*

- *The summer of 1990 brought a downward market that lasted three months and concluded in October 1990, at which point equity prices had fallen 22.4%. Then, in the same month, a new, now legendary, bull market took hold and lasted nearly eight years, until July 1998, delivering a 330.7% gain for the market.*

- *Since 1957 there have been 15 bear markets, as measured from peak to trough, and on average they have lasted 10 months and brought an average decline of 29.4%.*

- *The duration and degree of these bear markets were significantly less than the duration and magnitude of bull markets. During the same period, there were also 15 bull markets, which lasted, on average, 30 months and brought average gains of 112.5%.*

(Continued on next page)

(continued from previous page)

- *Consider in dollars and cents what some of these bear and bull markets would mean to a hypothetical investment: If you had invested $10,000 dollars in the S&P 500 on December 31, 1972, at the start of a bear market, your investment would have shrunk to $6,273 in the following two years. If you had the fortitude and stayed the course through these two difficult years and the slow recovery which followed before the next bull market - your initial investment would have grown to $24,989 by December 31, 1984.* Source: James Swanson, CFA

In volatile times like these, it is important to remember one of the most fundamental concepts of investing: stay the course. Consider your own investment time horizon, risk tolerance, and your financial ability to continue to invest through periods of low prices. During times of extreme stock market volatility there are some strategies that may enable you to stay the long-term course while keeping your risk in perspective and making these times more tolerable:

- If you are young, make time your ally. If you have more than a twenty year time horizon, let's say you are less than forty years of age, you should view the current market meltdown as a great opportunity. Time works to the benefit of young investors because of what Albert Einstein called the most powerful force in nature, the power of compound interest. The recent decline in stock prices has raised the dividend yield on stocks by 40%. An investor could now easily construct a basket of blue chip stocks that has a yield of 5%. That dividend should help dampen the fluctuation in the value of your portfolio while you benefit from the compounding effect. A dollar invested today will grow to $4.32 in dividends alone in thirty years. If corporate earnings grow at 1.5% and inflation averages 2.5% then $1 should grow to $13.27. Without the recent stock market decline, an investor would accumulate just $7.61 in the same thirty year period. This is a particularly appropriate strategy for a 401k or IRA.

- If you are in your early forties to mid-fifties, you would normally still have about 10 to 20 years until retirement. Since nobody knows what the next ten years will hold for the overall economy, you have to plan for either of the two extreme economic scenarios - inflation and deflation. You should be well diversified and re-balance the portfolio allocation on a regular basis. The exact allocation would be dependent upon your personal risk tolerance, but you should have a blend of stocks, bonds and commodities. Such a mix will preserve your purchasing power during either extreme economic scenario. To jettison stocks after a sharp sell-off and move into CD's or bonds exclusively is to leave your purchasing power at risk from the ravages of inflation. The proper mix of different asset classes will also reduce your portfolio's volatility.

- If you are retired or are planning to do so shortly then you need to be concerned with preservation of principal as well as the growth in your portfolio. Cash and bonds play a critical role in the portfolio of a retiree since they can help preserve principal. Unfortunately, cash and bonds do not always protect purchasing power. Stocks are an extremely volatile asset class that can move sharply in compressed timeframes, but over the long run stocks provide an excellent hedge against inflation. Stocks afford investors the opportunity for wealth creation and aid in preserving purchasing power. A helpful strategy for staying invested in stocks but still being able to sleep at times like this is to reduce your current holding of stocks but to then dollar cost average back into the market over some time frame. While you may miss some upside in the market, it is usually far more profitable than simply quitting stocks all together.

The investments you chose should correspond to your financial needs, goals, and risk tolerance.
Past Performance is no guarantee of future results