

Fear may thwart financial cures

By Michael Liedtke
Associated Press
Friday, October 10, 2008

San Francisco — Could it be just a year ago that jubilant investors were celebrating record highs in the stock market?

It almost seems inconceivable now as both Wall Street and Main Street stare into a seemingly bottomless pit of despair that has swallowed up \$8.3 trillion in shareholder wealth during the past 366 days.

"We aren't dealing with a fundamental economic issue any longer," said James Paulsen, chief investment strategist for Wells Capital Management. "We are dealing with fear. And that doesn't respond to economic medicine."

That hasn't stopped the U.S. government from trying to find a remedy.

In a series of moves aimed at avoiding the mistakes that culminated in the Great Depression nearly 80 years ago, the government already has committed to spend more than \$1 trillion to prop up ailing banks and other lenders during the past month of turmoil.

But none of it seems to be working, which only seems to be scaring people more, especially after the nation's leaders spent nearly two weeks painting a gloomy picture of the economic outlook to persuade Congress to approve a \$700 billion bailout of the banks.

"I think right now there are just some very powerful negative images that are alive in many people's minds — images of the Depression, images of people selling apples," said George Loewenstein, a behavioral economist at Carnegie Mellon University. "The images of the downside are just so salient in people's minds, and nobody has presented an upside image yet."

The quarterly 401(k) statements that are starting to arrive in the mail will only serve as another grim reminder of the financial carnage.

There are some logical reasons why stocks aren't worth as much as they were a year ago.

For starters, the U.S. economy appears to be in a recession for the first time since 2001.

To make matters worse, this contraction looks like it could be particularly painful, with home prices in their steepest slide since the Great Depression and banks in their shakiest condition since the savings-and-loan crisis of the 1980s and early 1990s wiped out thousands of federally insured institutions.

And some economic doomsayers still think it could get a lot worse.

"The economy has been in terrible shape for a long time. It was built on an illusion before this," said Mike Stathis, an investment consultant who wrote a book called "America's Financial Apocalypse." "I think people are starting to recognize what's coming, so why wait around for it to get worse?"

Major mutual fund companies like the Vanguard Group, Fidelity Investments and T. Rowe Price all reported sharp increases in phone calls this week as some individual investors bailed out of the market and others sought words of reassurance.

Paulsen said he believes the U.S. government has sounded even more alarms by announcing one different approach to the financial crisis after another in recent weeks.

"It made them seem scared, and it made them seem like they didn't know what they were doing," he said. "I think we have reached a point where the Treasury and the Federal Reserve have to just stop and send out this message: 'We have done enough, and we think it's going to work.'"

But until they get some credible words of reassurance, investors are likely to be on edge — much like a soldier suffering from post-traumatic stress, said Michal Ann Strahilevitz, a marketing professor at Golden Gate University in San Francisco who studies investor psychology.

"We've been so traumatized over the past few weeks that every little thing that happens, we overreact," she said.

With more gloom seemingly around every corner, investors run the risk of pulling their money out of stocks just when the market may be poised to bounce back.

The 39 percent decline from the Dow Jones' high already exceeds the drop experienced in the typical bear market, suggesting it may not be much longer before the sell-off bottoms out.

When investors act purely on emotion, there is greater chance of them sabotaging their financial goals, said Stuart Ritter, a certified financial planner at T. Rowe Price.

"The opposite side of irrational exuberance is irrational pessimism, and neither one is a good path to your financial goals," Ritter said.

John Dorfman, portfolio manager of the Dorfman Value Fund, is preparing for a rally after the United States picks its next president in the Nov. 4 election. "I see a lot of bargains out there," Dorfman said.

Even the generally pessimistic Stathis hasn't given up all hope. As more investors fled the market late Thursday, he bought 900 shares of Pfizer Inc.

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