

It's 11 p.m., Market Time. Do You Know Where Your Mutual Fund Managers Are?

The dramatic upturn in the stock market in 1995 has led to a great deal of investor satisfaction and complacency. We have enjoyed an extended bull market since 1982, punctuated only by brief "mini-bear" markets in 1987 and 1990. In addition, more than 80 percent of investments in mutual funds have been made since the last stock market correction of 10 percent or more in 1990. This all leads us to wonder how prepared investors are for the inevitable bear market. Much of the money flowing into mutual funds seems to be going to funds that have had the best records in the past few years. Chasing past performance is a sure way to be out of synch with the market in the future. The most aggressive, best performing funds in a buoyant market are unlikely to be comfortable holdings in a market meltdown.

The table below shows the total returns for some popular funds in the past two mini-bear markets:

	<u>September - November</u> <u>1987</u>	<u>August - October</u> <u>1990</u>
Columbia Special Fund	- 40.16 percent	- 28.77 percent
Heartland Value Fund	- 31.50 percent	- 23.74 percent
Kaufmann Fund	- 39.48 percent	- 23.98 percent
Scudder Development	- 35.33 percent	- 24.80 percent

How many investors flocking to "hot" funds at the top of the performance charts have contemplated the possibility of a 20 to 40 percent decline in their wealth?

Many fund managers may be just as unprepared for a bear market as fund investors. Sigma recently did a study of the 6,730 mutual funds in its database. Only nine percent of these funds had the same manager as at the stock market crash in October 1987. Only 1.6 percent of the funds had the same manager as during the 1981-82 bear market. Fewer than one half of one percent of the funds had the same manager as during the last major bear market in 1973-74. While there are some experienced managers at the helm of relatively new funds, the majority of mutual fund managers have not experienced the kind of severe bear market that used to be commonplace. How inexperienced fund managers and relatively new mutual fund shareholders react when we have a true bear market remains to be seen.

Investors should not expect future market declines to be as short-lived as the two bear markets shown in the table. Pain in the market is a function of price declines and time. While the 1987 crash was a very sharp decline, it was short. Prices began to recover almost immediately. In contrast, bear markets in 1969-70 and 1973-74 inflicted substantial pain both in terms of price declines and time. Since the bull market started in 1982, we have been trained to buy on dips -- every time the market declined, it recovered very quickly. In contrast, the Dow Jones Industrial Average first touched the 1000 level in February 1966 and did not substantially break through that level until late 1982. How many investors rushing into equity funds are contemplating the possibility of equity prices going nowhere for 16 years?

None of this argues against the wisdom of being a long term holder of equities as opposed to bonds, certificates of deposit or other less volatile alternatives. The way to build substantial long term wealth in the financial markets is to be an owner of equities. If you are not aware of the risks when you purchase a fund, however, you are likely to become disenchanted and sell it at exactly the wrong time. The best gains in the stock market typically begin during a period of maximum fear among investors.

So what should you do? If you are interested in finding out how your funds fared in the 1987 and 1990 market downturns, give Sigma a call at (503) 243-6056. We will be happy to run a bear market "check-up" for you. We will also send you a study showing how different investment styles have fared in previous market downturns. You should also take a hard look at the table above and ask yourself, honestly, how you would react to a decline in your mutual fund of the magnitude indicated in the table. If you would be inclined to sell the fund, you shouldn't be in that fund in the first place.

One of Sigma's primary missions is to help its clients develop rational, long-term investment strategies that do not depend on short term market movements. Sigma also helps its clients with the discipline to stick with their investment plans through the occasional inevitable adversity resulting from market cycles. If this interests you, please contact us.