

Disgusted at the Dinner Table

*We would have done better if we
had just left the money in the bank!*

If you hear this line at your dinner table, you will know we are in a secular bear market. In bull markets, emotions tend to be relative (“I’m smarter than my idiot neighbor, yet he has made a bundle betting everything on latte.com!”); you are unhappy making 30 percent if others are making 40. In bear markets, emotions tend to be absolute (“I’m losing money!”). If you lose 10 percent, you care little that others are down 20, or even that your neighbor is bankrupt and on his way to debtor’s prison.

Secular bear markets alternate between cyclical market downswings and somewhat smaller and shorter cyclical upswings. The down periods tug at the emotions and are large enough and sudden enough to keep your attention. The up periods rebuild investor sentiment. Over the long run, however, the market drifts down and people lose interest. Monthly brokerage or fund statements arrive in the mail and pile up unread. Finally, investors come to the realization that their portfolio has been a disappointment – and they would have been better off just leaving the money in a bank certificate of deposit (CD) or money fund.

In the last quarter of the 20th century, we experienced the largest, longest bull market in U.S. history, accompanied by “stocks for the long run” indoctrination from the financial media and academia. While it is true that equities have performed better over long periods than less-risky assets, the length of the long run may be of far greater duration than most investors realize:

(1) The Dow Jones Industrial Average first crossed 100 in 1906. Counting that advance, five of the next six bull markets (as defined by Ned Davis Research, Inc.) peaked within 10 percent of that level over the subsequent 20 years.

(2) The Dow peak before the 1929 crash was not exceeded until 1954.

(3) The Dow first crossed 1,000 in 1966. Ned Davis tells us that an investor who just put her money into a money fund (commercial paper) had more wealth than an investor who invested the same amount in the Dow Jones Industrial Average, reinvesting all dividends, until January 1987. The stock investor endured severe bear markets in 1966, 1969-70, 1973-74 and 1981-82, as well as periods of euphoria and speculation in between. Which investor do you think was sleeping better at night during those 21 years? Moreover, we are assuming the "long run" index investor did not get disgusted and sell in periods like 1974 when he was down more than 40 percent from a recent peak. We are also assuming he did as well as the index in his investing, which most investors do not.

*A money fund investor
did better than a stock
index investor for 21
years, from 1966-87*

Yes, you say, and there were periods in ancient Rome when investors had to endure long dry spells, too. But this is the modern age. We are perceptive, attentive, and well informed, helped by financial programs, magazines and the Internet. It is different now than it was in 1906, 1929 and 1966.

Except it may not be different. An investor in three-month CDs from March 1, 1998 through May 31, 2005 has earned more money than someone fully invested in the Standard and Poor's 500 index of U.S. stocks. We are now more than seven years into a period where "just leaving it in the bank" would have been the winning strategy. This is not widely recognized by investors. Hope springs eternal, with most measures of investor sentiment showing a lot of optimism. The stock market is still selling at historically high levels relative to business fundamentals.

We hope it does not take 20 years for investors to reach despair in their dinnertime discussions on investing. We *certainly* are not suggesting investors sell everything and rush into CDs - the anguish and desolation reflected in the "leaving it in the bank" realization accompany market bottoms, not tops. Instead, our point is that everything in the financial markets tends to run in cycles.

Nothing is free in this life, particularly in investing. Living through market vicissitudes and long periods of disappointing returns are part of the cost of an investment program. Knowing market history helps you inoculate yourself against the anguish and desolation that lead you to sell out when you should be buying. Emotional responses tend to destroy sound investment programs. The last quarter of the 20th century, the period that dominates our memories, was a wonderful period for investors. It would be a mistake, however, to conclude that it represented the normal state of affairs, rather than an anomaly.

In a blast furnace bull market, you do not have to be smart or even prudent - just throwing money at stocks tends to work. We have no clear vision of what the next decade may bring, but we believe it will be a period requiring much greater prudence, wisdom and discipline by investors. It is our job to help - call us at (503) 419-3938 or go to www.sigmainvestment.com.