The rational approach to portfolio management...

STRATEGICNEWS

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STRATEGIC WEALTH MANAGEMENT GROUP, INC.

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Points of Interest:

U.S. stocks have posted average annual gains of nearly 19 percent after major bear markets.

Market returns have been excellent in every five-year period following significant U.S. stock market declines since 1929.

A balanced portfolio that was invested 60 percent in stocks and 40 percent in bonds did pretty well over the past 10 years.

Bear Market Recoveries Can Be Rewarding but Also Difficult

Recovery from the great 2008 bear market has been slow, uneven, and, so far, disappointing.

The Dow Jones Industrial Average reached an all-time high of 14,066 on Oct. 5, 2007. It then began a stunning 17-month decline of 53 percent down to a low of 6,627 on March 6, 2009. It was the largest decline in U.S. and world stock markets since the Great Depression.

Investors who are shell-shocked from the wild ride they had in a big bear market find it hard to focus during the ensuing recovery.

The market bounced back quickly in 2009 through early this year, with the Dow hitting 11,205 in April. Since then it has meandered up and down as successive European debt crises and fears of a second recession in the United States buffeted investors who were still reeling from the late 2008 crash. Just before Thanksgiving the Dow was in the 11,200 range.

Recoveries are strong

While this doesn't feel too good, it is not at all unusual, says the American Funds mutual fund group, which published a study recently on stock market recoveries.

In fact, market returns have been excellent in every five-year period following significant U.S. stock market declines since 1929, the company said.

The average annual gain on the Standard & Poor's 500 Index during these periods has been 18.95 percent per year, well above the stock market's long-term gain of about 9 percent per year, the company said.

The average annual returns ranged from 9.31 percent in the five years after the 1968-1970 bear market, to 36 percent per year after the 1929-1932 bear.

After the bear market of 2000-2002 stocks rose by an average of 17 percent annually for the next five years.

But they feel bad

Looking back it seems like an easy call—invest right after a bear market and be happy, since your returns will be above average.

But that's not the way it works, American Funds says.

Instead, the recoveries are uneven ("rocky," the company says) and investors feel "like they have to react to every bump along the way."

Consider the bear market of 1973-74 that followed America's unwinding from the Vietnam War.

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Look Beyond Today's Scary Headlines and Stay Invested

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The S&P 500 Index dropped by 48 percent over a 22-month period. Over the next five years, it rose at an annualized rate of over 17 percent. Yet that progression was hard to see for investors in the midst of current events.

During that period stocks fell by 10 percent or more four times, each time causing some investors to step back and wonder if another crash was in the offing.

There were plenty of bad headlines as well, including:

- Unemployment peaked at 9 percent in 1975.
- New York City nearly went bankrupt in 1976.
- A major energy crisis erupted in 1977.
- In 1979 the Iran hostage crisis erupted and inflation hit 13 percent.

Keep invested through a recovery.

Do these sound a little like today's headlines - conflict in Korea, unemployment at 9 percent, Greece, Ireland, and Portugal threatening default?

It all seems pretty scary. Investors who came out ahead during those past recoveries had to look past current headlines in order to stay focused and invested, and that is a pretty good prescription for today's investors.

It's About Time to Stop Whining About the Stock Market's "Lost Decade"

You are not alone if you are tired of seeing headlines about the stock market's alleged "lost decade."

Financial journalists and market pundits alike have gone to town with this story: From the end of 1999 through today, the "stock market" has gone nowhere and investors have made virtually nothing on their investments.

It makes for shocking headlines, but the story is, in a word, wrong.

It is based on just one stock index—the Standard & Poor's 500 Index– which stood at 1437 at the end of September 2000. Ten years later, at the end of this past September, it had declined to 1141.

But most investors don't put all of their money into one index. Those who had just a little diversification outside the S&P 500 had positive returns over the last 10 years.

A narrow index

The S&P 500 includes the 500 largest U.S. companies and represents a large part of the U.S. stock market's capitalization.

But it is also a narrow index in the sense that it is dominated by a smaller number of large growth stocks (in the three years leading up to the market crash of 2008, it was dominated by a handful of financial stocks).

It leaves out roughly 60 percent of the world's stock market capitalization, and, of course, does not cover the government and corporate bond markets either.

This past decade has been a particularly tough time for the S&P 500, says Craig L. Israelsen, a professor at Brigham Young University who specializes in personal finance.

He says the recent decade was one of only four in which the S&P 500 lost money—two back in the Great Depression, and the third covering the period 1999 through 2008.

But other parts of the investment markets have offered positive returns over the 10 years through Sept. 30.

The bond markets were positive. Depending on the risk and maturity of bonds they held, investors earned from 5 percent to almost 7 percent per year on bonds, according to indexes maintained by Barclays Capital.

Small stocks gain

Meanwhile, small U.S. value stocks did much better, returning an average of 7.7 percent per year, according to the Russell 2000 value index.

Foreign stocks also outperformed the S&P 500 over the last 10 years. Big foreign stocks, as measured by the MSCI World Index (with U.S stocks excluded) gained almost 3 percent per year.

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Balanced Investment Portfolios Enjoyed Profits After Inflation

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Emerging markets stocks soared, returning an average of 13 percent per year, based on the MSCI Emerging Markets Index.

Try a little balance

An American investor who invested in a balanced portfolio that included some foreign and emerging markets stocks, some small U.S. value stocks, and short term bonds from around the world had a decent experience over the decade.

A simulated balanced portfolio of 60 percent stocks and 40 percent bonds tracked by Dimensional Fund Advisors showed a 6.8 percent average annual return.

Even better, the investor enjoyed real growth in his portfolio after subtracting the effects of inflation.

Over the 10 years ended in September the Consumer Price Index rose by 2.4 percent per year; the balanced investor earned 4.4 percent per year after inflation.

Have Stocks Become More Volatile?

The tremendous dislocations in the stock market over the last few years have made investors wary of volatility.

They had to contend with huge swings in prices during the September-October market crash of 2008, and then the nearly 1,000 point drop in the Dow during the "flash crash" on May 6.

Of course, the type of volatility investors worry about involves downward movements; they don't seem to worry when the market is jumping higher.

Down days stable

A study by The Mutual Fund Store, an investment firm based in Kansas, shows that the number of trading days the U.S. stock market closed with a loss has not changed much over the years.

Between 1970 and 1989, the market closed down on 48 percent of trading days. From 1990 to 2008, the market closed down on 47 percent of trading days.

And this year through mid-September, the market closed down on just 46 percent of trading days, the firm's research center told Investment News, a trade publication.

40-year history

"Perceptions of abnormal volatility are not accurate," the firm reported. "Across a range of measures, the stock market's ups and downs are almost identical to those seen every year for the past 40 years."

The study found that the average year has 120 down days, and that the range between good and bad years is relatively small.

The best year was 1995, when there were 96 down days the worst was 1974 with 146 down days.

One intriguing finding showed that strings of down days are rarer: the market seems to bounce back more quickly than in the past.

From 1970 through 1989, strings of five straight down days occurred 3 percent of the time, while from 1990 to 2009, such long stretches of decline occurred only 1 percent of the time.

Bigger drops

If anything has changed, it is the magnitude of declines, the study found. One-day declines of 2 percent or more doubled in recent years when compared to the period of 1970 through 1989.

"These findings suggest that electronic trading, high-frequency trading, and other changes in stock markets have sped up the market's adjustment," the study said.

Bigger one-day gains have also become more frequent in recent years, the study found.

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Savings Shortfall, Still Confident & More

The average American household faces a pretty stiff retirement fund deficit—$90,000 to be precise, says the Center for Retirement Research at Boston College.

It used Federal Reserve statistics to look at the retirement savings of 70 million households with workers between the ages of 32 and 64.

It says its estimated household shortfall is conservative, because it doesn't project any future cuts in Social Security benefits. "It's a measure of how far behind Americans are in their retirement savings today," a spokesman said.

Investors hang in

Two years of rollercoaster financial markets have done little to shake investor confidence, says the Center for Audit Quality in Washington, DC.

Its fourth annual survey showed that investor confidence stands at 68 percent, just a little below the 70 percent level it stood at during the 2008 crash.

However, confidence in government plans to fix the economy dropped from 31 percent to 22 percent over the last year.

The young like Roths

Younger savers are converting to tax-free Roth IRAs at a faster pace than any other group, Fidelity Investments says.

The reason may be that younger investors have many years of tax-free growth ahead of them when using a Roth, which makes up for the requirement to pay taxes today on any IRAs converted to Roths.