
What You Need to Know to Survive Depressed Markets

Let's Begin with Some Market Truisms

1) The stock market (as measured by the S&P 500 index) was UP 22 of the last 32 years, or 69% of the time; The stock market was DOWN 8 of the last 32 years, or 26% of the time; The stock market was EVEN 2 of the last 32 years, or 5% of the time.¹

2) Investors' risk of sustaining stock market losses decreases as one's holding period increases. According to Ibbotson Associates, an independent research firm, stock investors holding positions for 1 year suffered losses 29% of the time; stock investors holding positions for 5 years suffered losses 13% of the time; and the average stock investor holding positions for 15 years suffered ZERO loss in the overall rolling period.²

3) Timing the market is near-impossible; selling one's portfolio in a down market may trigger two unintended consequences: (1) potentially onerous taxes, and (2) missing out on the market's rebound. At the end of this article, see the chart illustrating the cost of missing out on stock market rebounds since 1980.

4) The most significant factor contributing to portfolio performance is asset allocation (the portfolio's diversification among stocks, fixed income, cash, & other assets). According to Ibbotson Associates' 2005 study, 91.5% of an investment portfolio's performance is due to its asset allocation. Favorable market timing, specific security selections, & other factors (including dumb luck) account for the remaining 8.5% of total return.³

5) Risk drives return! The "risk free" rate of return is generally associated with the U.S. Treasury bill. (As of this writing, the 3-month T-bill yield is 1.38%). Stock investing carries a "risk premium" to investors in exchange for the

potential to achieve superior returns. According to the latest Ibbotson research, over the last 82 years ending December 2007, large company stocks have returned an average 10.4%, government bonds have averaged 5.5%, and Treasury Bills have averaged 3.7%.⁴

6) Last year's asset class winners (small stocks, large stocks, international stocks, long-term government bonds, etc) or sectors (pharmaceutical, technology, commodities, financials, etc) tend to be next year's losers. Once most individual investors recognize this year's trend, it's too late to join the party.

7) Hidden costs matter! The unadvertised enemies of your portfolio: inflation, taxes, fees, & trading costs can have a significant impact on one's investment return, especially if the portfolio has high turnover (frequent trading of direct positions - or underlying securities in a managed mutual fund). If your portfolio contains annuities, stiff surrender penalties may take five to twenty years to break even on mortality and expense charges, after which time you may incur higher income tax rates than typical capital gains rates assessed on profits on other investment classes.

The extent of one's individual impact from frequent trading and taxes on sales cannot be quantified by sellers of the investments, so you will need to determine this effect yourself, or with the help of your advisor. However, the very fine print of mutual fund and annuity prospectuses will disclose built in annual fees, one-time loads, and surrender penalties.

The inflation rate you cannot control – therefore you should remain cognizant of this "hurdle rate" which your portfolio must exceed to overcome annual purchasing power erosion.

Now What?

The Wall Street Journal reported in the July 1st, 2008 issue “Since World War II through 2007, the Standard & Poor’s 500-stock index has risen by an annual average of 9.1%. Add in dividends and it increased 13% yearly. During that time, the consumer-price index – the real kind, which includes energy and food – averaged 4.1%.” I concur with the author’s advice to investors in this current market: “Buy good stocks cheap, trading at multiples below the market’s.”

I advocate “Stocks for the Long Run”⁵ as key to wealth accumulation and for sustaining cash flow distributions for lifetime support.

To paraphrase Economist Jeremy Siegel in his book *The Future For Investors*, while it is true that stocks incur a *risk premium* over short holding periods, that risk actually decreases over time, falling below the risk of fixed-income assets over 20 years or longer.

Inflation is the reason for this. “Inflation afflicts real bond returns far more than real stock returns. Bonds are promises to pay dollars, not goods or purchasing power. *[Inflation-adjusted instruments excepted]*. Stocks, on the other hand, are claims on real assets, such as property, machines, factories, and ideas.

Over time the price of these assets will rise with inflation. The behavior of equity returns confirms that over long periods of time, stocks fully incorporate realized inflations, while bonds, by their very nature, cannot.”⁶

Here is a survey of asset class average returns over the last 20 years:⁷

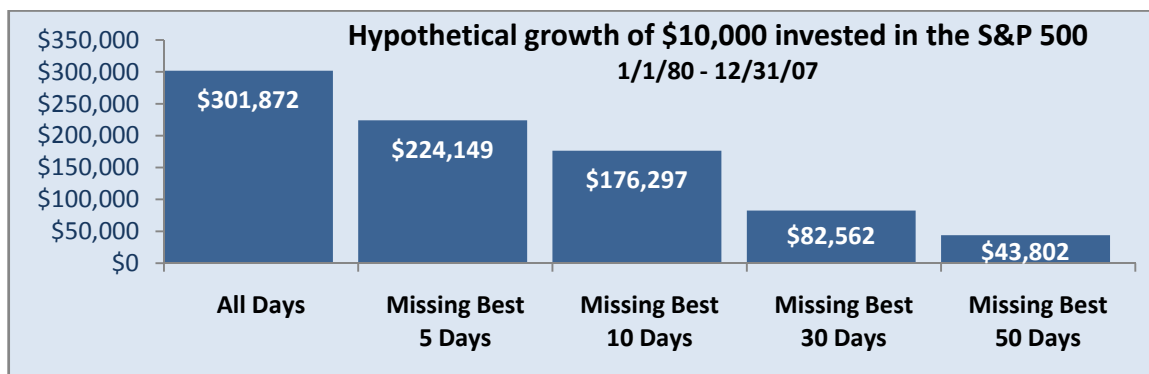
- U.S. small company stocks: 13.5%
- U.S. large company stocks: 11.8%
- Government bonds: 9.3%
- Treasury bills: 4.5%
- Commodities: 10.2%
- Real estate: 8.8%
- Gold: 2.8%

Inflation has averaged 3% over that time.

When the evidence is clear, your investment decisions should be easy.

“...Stocks, with their superior returns and lower long-term risk, should be the cornerstone of all long-horizon portfolios. Bonds are demanded by those wanting refuge from the short-term volatility of the stock market and therefore offer much lower returns. But bonds do not hedge...inherent inflation risk.”⁸

Prepare yourself to weather depressed markets. Stay invested. If excess cash is available to you, take advantage of buying opportunities during these down cycles.



Source: Market Analysis, Research and Education (MARE) Group, a unit of Fidelity Management & Research Co. (FMRCo) as of 12/31/07.

ASHLEY FINANCIAL SERVICES PA, CPA
[REGISTERED INVESTMENT ADVISOR]
CERTIFIED PUBLIC ACCOUNTANT

2856 Carrie Ln, Lakeland, FL 33812
Ph: 863.446.1650 E-Fax: 863.223.0260
ashleyfinancialservices@verizon.net
www.ashleyfinancialservices.com

Credits: 1,2,3,4,7: Ibbotson Associates Inc, independent market research company, a division of Morningstar, Inc.
5,6,8: Professor Jeremy J. Siegel, Ph.D., Wharton School, University of Pennsylvania, author's except from "The Future for Investors – Why the Tried and True Triumph Over the Bold and the New"