

Bear Markets, Wall Street, Washington, Financial Media and Other Murky Topics



The majority of today's investors learned about the stock market over the last twenty five to thirty years. That period was dominated by a Secular (long-term) Bull Market that began in August 1982. The prevailing strategy that evolved out of that era was to buy good stocks or mutual funds and hold for the long term, “Buy and Hold” for short. The first decade of this century has investors rethinking that philosophy and reviewing who, what, and where their best sources of investment information come from.

Entering the financial services industry in the mid-eighties, I was enamored with the mechanics of how investments worked. I realized after the first ten years I was essentially a salesman pitching the philosophies and products that seemed to be tilted more toward the best interest of the firm that I worked for rather than the clients I represented. I began to shy away from packaged products that “The Street” created with all the sizzle of the current investment fad, but usually produced little in the way of profits for investors.

In the late nineties I began to follow the stock market closely and read extensively about its history. One thing that clearly jumped out at me was the long term cyclicity of equities. There were several periods when stocks made no progress for nearly one to two decades. This evidence was most clearly portrayed in the table below excerpted from a book titled “Why Stocks Won't Outperform Money Markets for the Next 20 Years” which was written by Michael Alexander before stocks fell precipitously in 2000-02. For the first ten years Mr. Alexander has been accurate about his prediction as this past decade recorded the first negative return for a decade since the thirties. Hopefully he is not accurate about the second half?

The table clearly shows that there have been fourteen distinct long term cycles, seven Bulls and seven Bears. As you can see from the bottom line that all the progress has essentially been made in the bullish periods. What I also noticed was that many of the Secular Bear Markets began after an extremely speculative and frothy run, for instance the Roaring Twenties led to the Great Depression. At the time we happened to be in the latter stages of the dotcom bubble.

Secular Bear Markets			Secular Bull Markets		
Time Period	Yrs.	Annual Return	Time Period	Yrs.	Annual Return
1802-1815	13	+ 2.80%	1815-1835	20	+ 9.60%
1835-1843	8	- 1.10%	1843-1853	10	+ 12.50%
1853-1861	8	- 2.80%	1861-1881	20	+ 11.50%
1881-1896	15	+ 3.70%	1896-1906	10	+ 11.50%
1906-1921	15	- 1.90%	1921-1929	8	+ 24.80%
1929-1949	20	+ 1.20%	1949-1966	17	+ 14.10%
1966-1982	16	- 1.50%	1982-2000	18	+ 14.80%
Overall	95	+ 0.03%	Overall	103	+ 13.20

Although our stock market had experienced a huge, frothy rally in the latter half of the nineties, one country was mired in a Secular Bear Market. “Made in Japan” was the dominant sticker on products produced in the seventies and eighties, and the Japanese Nikkei actually peaked the first day of the nineties. The nineties saw the Nikkei fall as much as 60% from its peak and I used that decade as a key component in my presentation showing clients and prospective clients that we could experience

something similar. I still use their market as a possible outcome today as the Nikkei hovers around 10,000. The first time the Nikkei hit that round numbered threshold was in 1984. Imagine someone telling you that the Nikkei, which had gone up eight fold in the previous ten years, would not make any progress for the next 26 years! They would probably be summarily dismissed. Could it happen to the US market? Mr. Alexander thinks so.

In late 2000 I was convinced that a Secular Bear Market was probably afoot in our market and if I was right the Buy and Hold strategy would be ineffective and possibly disastrous. I felt my clients needed a strategy that was flexible, nimble, and cost effective. Looking at these past Secular Bear Markets I thought an important key was the need to get out of the way of nasty corrections for possibly significant periods of time. Capital preservation becomes more important than long term growth when we transition from a Secular Bull to a Secular Bear. I found a couple of mutual fund families that catered to those who attempted to be nimble and flexible and my platform was born.

My initial attempt to promote a market timing service was as a tool to diversify strategies as well as asset classes. It was met lukewarmly with comments like “No one ever presented that type of strategy to me before?” to “Don’t you know no one can time the market!” Those who argued most against the strategy were other brokers and advisors. I got so tired of arguing about the benefits of market timing that I titled my strategy Dynamic Asset Allocation Strategy (DAAS). I got the impression that most investors thought that Buy and Hold was a pure, wholesome process heralded by the iconic Warren Buffet and Peter Lynch. Market timers were step child misfits who just didn’t get it.

I began to sense that Wall Street had crafted the Buy and Hold mantra as a way to keep clients in a perpetual state of optimism, with the failsafe comment “The market always comes back.” Selling investment products to consumers who were unsure or downright pessimistic about the future was far less fruitful than pitching those who were under the impression that eventually the market will solve their financial goals. Heck they had absolute proof with the aftermath of the 1987 crash, within less than a year the market had retrieved all its losses. In fact looking at this chart from 1982 to 2000 the Crash looks like barely a speed bump.



The synching of Buy and Hold with the investing public and the financial advisor sales force was deep and thorough. I found many unwilling to consider the possibility of a decade without progress in the stock market as few had actually experienced an uncooperative equity market for much more than several months. It was actually the core piece of a business model that Wall Street crafted to effectively sell product through a variety of channels through salespeople dressed up as “advisors”.

The media was part of the sales pitch as a chunk of their advertising revenue comes from the firms selling these financial products. The cheerleading message beamed out by the dominant financial channel CNBC is so thick that most professionals who watch the channel have it on mute. I can rattle off several talking heads that represent large financial firms and have been regular guests on CNBC for years that have yet to share a cautious thought about the market. Even with two fifty percent corrections this past decade there has never not been a good time to buy stocks in their mind. If you are selling some form of traditionally managed portfolio like a mutual fund, talking cautiously about the markets has a direct negative effect on sales. CNBC ratings have been known to plunge during market retreats.

Another group that benefits from a stock market that moves higher and to the right across a page is our politicians in some Washington. Strong market usually means a strong economy and a strong economy usually means votes. Some suspect an entity Ronald Reagan created after the 1987 crash, The Working Group on the Financial Markets, have now used their resources to make the stock market look stronger than it really is. Known as the “Plunge Protection Team” they are accused of buying futures to keep the market from falling precipitously, [click here](#) for a more in depth article. Also the economic data the

government regularly releases has become so questionable that John Williams has created an effective and popular website named shadowstats.com.

The timing of the 9/11 attacks appeared to be no coincidence. We had not had a consumer recession, let alone a hiccup, since the very early nineties and the appearance of one loomed large. Hitting us when we were vulnerable was part of their execution (For those who are not aware the markets around the world, especially airline stocks, acted poorly in the days preceding the attack as the terrorists shorted the equity markets). The policymaker reaction to the event was to create tax cuts and aggressively lower interest rates. I remember President Bush asking us to go shopping and the American consumer complied. Low interest rates combined with a Congress induced desire to have every one own a piece of the American Dream led to a real estate boom of epic proportions. I read at one point in 2005 that the real estate industry was responsible for over 25% of the jobs in our workforce.

By mid 2006 just about every asset class was enjoying a surge that made the 2000-03 correction a faint memory. Florida condos and Las Vegas houses had replaced the dotcom stocks as cocktail conversation among the faddishly informed. The price of gold tripled, the price of oil moved up five fold, and the Dow Jones Industrials eclipsed its all time previous high made in 2000. Those who held their positions through the carnage earlier in the decade felt a form of vindication and relief, for staying the course.

We essentially had to create a bubble to solve the symptoms of a previous bubble. Soon we became familiar with a form of mortgages known as sub-prime. Comments from Fed head Bernanke in early 2008 that the subprime issue was a small part of the mortgage/real estate industry and well contained were just as misguided as the policies he and his predecessor enacted...IMHO. Obviously it was not contained and the intertwining of ill-equipped home buyers to Wall Street salesman to pensions/municipalities/countries became a domino game of financial destruction.

The cheerleading media message during this deflation was that it was just another bump in the road. Most talking heads proclaimed every pull back an opportunity (At some point they were right and that is the clip they save for their sales promotion). It was about this time I noticed the investing public finally catching on to this cozy relationship and the lack of trustworthy message it produces. The John Stewart interview with Cramer appears to be a tipping point in the process as Mr. Stewart undresses Cramer and many of the inconsistencies the network brings to the table. If you have not seen it and are curious about the drawbacks of using the financial media as a resource, take a few minutes and [click here](#).

The bursting of these asset bubbles brings to bear topics that will be the focus of many a financial business school thesis for years to come. Has the greed that gripped many players in the system overwhelmed the system? Is the free market capitalism that made our country the most powerful, wealthy, and respected in history now found its limits? Some say free markets work until they don't and then it will get ugly? Can the government put checks and balances through an effective regulatory process that creates a system that benefits the most instead of a select few? Historically every super power has become not a super power. Is this issue a door opener for China to leap frog the US?

Our policymakers are in the process of struggling to answer most of those questions as you read this. You have those in Washington attempting to regulate those on Wall Street. A trio of daunting thoughts regarding that encounter; 1) I find Wall Street folks seem to always be one step ahead of the Washington crew, 2) the Wall Street players are some of the biggest contributors to Washington, maybe explaining number 1, and 3) we are looking for answers to the crisis from those that created the crisis?

What makes the situation even more interesting is the number of Wall Street honchos who now are policymakers. Working at Goldman Sachs seems to be a stepping stone for many Treasury officials of late? Some have questioned the bail out of the banks as an effort to support the colleagues they left behind in the private sector. Difficult to tell with the lack of transparency both Wall Street and the Fed/Treasury are known for. With the financial sector being one of the largest contributors to the politicos in Washington, it is hard to imagine much changing without that part of the equation being overhauled?

So what is an investor to do? How do you build a portfolio in these times of incredible uncertainty? Who do you trust to provide solid financial advice when conflicts of interest dot the playing field? How do you compare the dynamics in play now when it appears that there have been few if any similar situations in the past? With interest rates near zero, fixed income investments do not provide the growth potential and growth investments have an extremely checkered recent history.

As far as portfolio construction is concerned, I believe flexibility is an absolute key component. Some say a new Secular Bull Market is underway and we can now build long term portfolios. They may be right, but if they are wrong, the Buy and Hold strategy could be hazardous to your wealth. The table here compares some of the key factors from the summer of 1982, the start of the last Secular Bull Market, and the current environment. It is never a good idea to tell the market what it is going to do, but it appears that there are several distinct headwinds that need to be overcome before a new Secular Bull Market begins to gallop? For information about the Dynamic Asset Allocation Strategy I created [click here](#).

United States	1982	2009
Fed funds rate	18% and only one way to go (down)	0% and only one way to go – up
10-year bond yield	15% and falling	3.8% and rising
Monetary base	\$170 billion and rising	\$2.2 trillion and stable to falling
Budget deficit-to-GDP ratio	-3% and moving towards a surplus	-10% and steady or falling from here
Household debt-to-personal disposable income ratio	62% and rising	123% and falling
Inflation rate	10% and falling	0% and rising
Savings rate	10% and falling	4% and rising
Unemployment rate	10.8% and falling	10% and rising
Misery index	At 16 and falling	At 12 and rising
Labour force participation rate	64% and rising	65% and falling
Tax rates (highest marginal)	69% and falling	35% and rising
Union share of the job market	20% and falling	12% and rising
Global trade barriers	High and falling	Low and rising
Profit margins (room for expansion?)	6.0%	10.0%
S&P 500 P/E ratio (1-year trailing)	8.0x	20.0x
P/E ratio (10-year normalized in real terms)	7.0x	23.0x
S&P 500 price-to-book ratio	1.0x	2.2x
S&P 500 dividend yield	6.0%	2.0%
Investor sentiment	10% bullish	88% bullish
UoFM opinion on government policy	80% and rising	80% and falling
Baby boomer population	Median age is 25, peak spending and investing years ahead (capital gains)	Median age is 52, retirement focus ahead (capital preservation)

Source: Haver Analytics, Gluskin Sheff

Attempting to determine if a financial firm/advisor has your best interest in mind here are a few questions to put to them;

- Have you reviewed previous Bear Markets that have occurred domestically and globally?
- Do you have a strategy that can take advantage if the Secular Bear Market continues to unfold?
- How did you advise your clients in 2000-02 and 2008 about their stock portfolios?
- Are there investments you provide that are uncorrelated to US equity market?
- Do you have access to investments that will profit if the stock market corrects significantly?
- Is there a level of pullback in the major indices that will change your current strategy?
- Does your firm in any manner trade against its clients?
- And the age old question “How and how much are you and your firm paid?”

So it seems like the issues of how Wall Street, the financial media, and Washington impact the investment landscape have gotten more attention in the last few years. Some might argue that this has been going on all along, but the profits that a Secular Bull Market produces for everybody tends to dampen down the suspicious thoughts. On the flip side, finger pointing is often a natural next step for those who experience heavy losses. Another interesting point is to remember that many of the dark figures behind the scams dotting Wall St. (Enron, Worldcom, most Ponzi schemes) did not start necessarily with criminal intent. It seems the system enticed them from grey to criminal as the chase for the almighty dollar blurred what ethical vision they possessed. It is funny how a poorly behaving stock market reveals many of those with criminal/unethical intent?

The bottom line is that the job investors have to shepherd the investment monies have become as challenging as they have ever been, certainly for the near retirement baby boomer generation. One of the more appealing aspects of a Secular Bull Market is that Buy and Hold is much simpler than the caution and vigilance a Secular Bear Market commands. Hopefully I have provided a few insights that frame some questions that lead to decent outcomes for your investments.