

Will the Markets Ever Recover?

With 2002 but a recent memory, investors are left with the harsh reality of the 3rd consecutive year of negative performance. Not since the great depression of 1929 have investors felt so abandoned by the equity markets. With the largest market indicators down in 2002 from 13.97% on the Toronto Stock Exchange to 23.37% on the Standard & Poor 500, investors have been left wondering if the markets will ever recover?

At the depths of market lows it is common to feel anxious about the volatile markets and to harbour nothing but pessimism. Particularly when the drop in market valuations is as prolonged and steep as this has been. Furthermore, the media is doing an outstanding job of hyping the negative as much as they exaggerated the positives leading up to 2000. But it is important to remember that history repeatedly shows that periods of decline – even when an index loses up to half of its value – are traditionally followed by significant recovery.

Look back to 1990 just before the bull market really started snorting in 1991. War with Iraq loomed, recession raged, investors yanked money from stock funds. State and local governments faced huge deficits. Big banks reported frightening loan losses. Junk bonds were a mess. By the fall of 1990, the U.S. Stock market had tumbled nearly 20 percent. A terrible combination, worse than the crash of 1987, more dreadful than the bear market of 1973-1974, more horrible than the 1981 and 1982 recession. America was considered washed-up in 1990, unable to compete with other world economies. All that pessimism about the future turned out to be misguided.

We can all find reasons to be pessimistic. If it's not the bad economy it's the deplorable corporate scandals. But as investors we have to view the big picture. As despicable as it is, corporate greed is a fact. Companies the likes of Worldcom, Enron and Tyco have existed since the start of capitalism. However, steps are continuously being taken to curb and abolish these types of problems. Even so, these types of companies only make up 5% of the S&P 500. That leaves 95% of the S&P that didn't go bankrupt or have allegations of fraud. That's the value of diversification. For example, if an investor had invested \$10,000 into each Kmart and Wal-Mart 20 years ago, the Kmart investment would be worth nothing (due to Kmart's bankruptcy last year) but the Wal-Mart investment would be worth \$790,000. That's a 20.17% compound rate of return even though half your investment went bankrupt. People can easily point to Enron and other examples of companies that pushed the envelope too far, but there are more than 9,000 other companies out there.

Don't wait for hindsight. It's hard to see trends as they take shape. It's easy – maybe too easy – to see things the morning after. The 1990's were no exception. All the pessimism in 1990 turned out to be wrong. The U.S. went from running a federal deficit to running a major surplus and it became clear that the U.S. was an incredibly strong economy. People went from saying, "We're hopeless" to "We're invincible. We may never have another recession again." Today, of course, millions of scorched investors having gone from one extreme to another appear to be overly pessimistic.

Will the markets recover? No one knows the future, but history indicates they will. The U.S. economy has seen 10 recessions since 1945, and it has emerged from 9 of them stronger than before. Of course, it's not a fact yet that they'll pull out of number 10 in better shape, but betting against the U.S. in the past has not proved to be a winning strategy.

Regards,

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