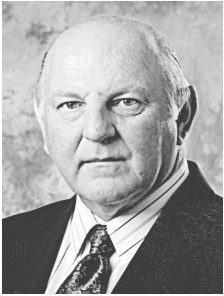


## Bear Markets: A Snapshot of History



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*"I know of no way of judging the future but by the past."*

-Patrick Henry 1775

It should be of little wonder why stock prices are on the decline. I blame the five C's: credit, crude, currency, confidence and the consumer. The nation's banking system is in shambles. The value of many bank loan portfolios appears to be far less than the amounts recorded on their books. A handful of banks have failed this year and banking experts fear more failures lie shortly ahead. The price of a barrel of crude oil (which traded at an unheard of price of \$85 a year ago) has recently approached \$150, and drivers are paying more than \$4 a gallon to fill their gas tanks.

The value of the U.S. dollar (the world's reserve currency) has plummeted against most major currencies. A few years ago, ninety cents would buy one Euro. As of July 2008, you have to pony up nearly \$1.60. If the dollar weakens much more, you could find that the Euro has replaced the dollar as the world's reserve currency, and the U. S. economy would assume second-class status. A lack of confidence in the dollar, the economy, and the U.S. financial system has caused investors of all kinds to divert their investment capital elsewhere.

Finally, the U.S. consumer is being battered by ever increasing food and energy prices, falling housing and stock prices, higher prices for imported goods,

and shrinking real wages. Things have apparently become so sorrowful that some financial pundits have even begun to use the word "depression" when describing their outlook for the U.S. economy.

As painful as this bear market has been, history suggests that it could get worse before it gets better. The data in Table 1 present a snapshot of three of the worst bear markets in my lifetime (I was born in 1942). From peak to trough, the decline in the stock market (measured by changes in the Standard & Poor's 500 Index) during these three bear markets averaged a whopping 41.5 percent. As can also be seen, the final months of these bear markets, on average, accounted for more than half of bear market decline.

It is during the selling climax in the waning months of a bear market that many investors make a tragic mistake. Not only are the values of their equity portfolios rapidly deteriorating, it is during these periods that the pain for many investors becomes too much to bear. To quell the ongoing pain, many investors dump their investments and lock in substantial losses – losses that may never be recovered.

Most investors know the way to profit handsomely in the stock market is to buy low and sell high. However, emotion frequently trumps reason. Investors tend to jump on bull market bandwagons well after the easy profits have been made, and they jump off after its wheels have fallen off.

It takes a lot of courage to hold on to stocks during a prolonged bear market, and it takes a herculean

effort to buy more shares as stock prices decline. Whenever I am tempted to jump ship during a long bear market I try to remember three things. First, like all life's experiences, stock market investing is accompanied by both joy and pain. Second, today's pain always seems to be more severe than an equivalent level of pain experienced in the past. Finally, if something cannot go on forever, it will eventually end.

**The money you save by being out of the bear market during its waning months is more than lost by the gains you miss during the early stages of the market rebound.**

When bear markets end, investors who have held on and have added to their investments have potential to garner their best returns. Those who bail out and miss the upturn in stock prices, lose returns they may never recoup. The data in Table 2 underscore these points.

Being out of the stock market during the final three months of a bear market can save you plenty. However, those who subsequently miss the first three months of a subsequent stock market rebound lose more than they saved. When the stock market rebounded after the 1968-1970 bear market, the S&P 500 Index gained 7.3 percent during the first month, 26.7 percent during the first six months, and

37 percent during 12 months. After the 1973-1974 bear, the market gained 16.3 percent in the first month, 31.2 percent in six months, and 32.1 percent during the 12-months following the bear market's end. Although the market rebounded a mere 0.8 percent during the first month following the 2000-2003 bear market, it rose 19.8 percent during the subsequent six months and 36.1 percent after a year. Thus, during the subsequent rebounds from these three severe bear markets, stock prices rose an average 8.2 percent during the initial month, 25.9 percent during the first six months, and 35.1 percent during 12 months.

Table 3 illustrates the action of small cap stock prices (defined as the bottom quintile of securities listed in the NYSE/AMEX/NASDAQ as ranked by market capitalization) during the rebound from the three severe bear markets. Although the average small cap stock gain during the first month of the rebound was less than that of large cap stocks (an average of 5.8 percent versus an average of 8.2 percent), small cap stocks continued their robust gains over the subsequent six and 12-months (up an average of 36.7 percent after six months and 60.6 percent over 12 months). This return pattern should not come as a big surprise. The market's rebound is generally fueled by investors who confine their purchases to large and giant cap stocks. Once individual investors become convinced that the bear market has truly ended, they begin to add to their small and micro cap portfolios. Given the limited liquidity in

**Table 1: Severe Bear Markets**

<u>Bear Market</u>	<u>Total Decline</u>	<u>Final Month Decline</u>	<u>% of Total Decline</u>
Dec 1968-June 1970	-32.9%	-18.9%	57.4%
Dec 1973-Sept 1974	-46.2	-26.1	56.5
Apr 2000-Sept 2002	-45.6	-20.2	44.3
<b>Average</b>	<b>-41.6</b>	<b>-21.7</b>	<b>52.7</b>

the smaller company segment of the market, renewed interest by investors eventually sends their stock prices markedly higher.

If you want to dodge the carnage caused by severe bear markets, you have to continually bail out shortly before they begin. However, we know of no one who possesses this uncanny ability. If you bail out of the market once you recognize that a severe bear market has begun, it is usually too late to profit. The money you save by being out of the market during its waning months is more than lost by the gains you

miss during the early stages of a stock market rebound.

So what should an investor do? First, take a long-term approach to wealth accumulation. Continually add to you portfolio in up and down markets. Second, recognize that there will be times when the value of your portfolio will decline temporarily. Third, avoid the urge to liquidate your portfolio when your pain is greatest. Finally, maintain a diversified portfolio that contains no more risk than you can tolerate.

**Table 2: Large Cap Market Rebounds**

<u>Bear Market</u>	<u>1 Month Rebound</u>	<u>6 Month Rebound</u>	<u>12 Month Rebound</u>
Dec 1968-June 1970	7.3%	26.7%	37.0%
Dec 1973-Sept 1974	16.3	31.2	32.1
Apr 2000-Sept 2002	0.80	19.8	36.1
<b>Average</b>	<b>8.2</b>	<b>25.9</b>	<b>35.1</b>

**Table 3: Small Cap Market Rebounds**

<u>Bear Market</u>	<u>1 Month Rebound</u>	<u>6 Month Rebound</u>	<u>12 Month Rebound</u>
Dec 1968-June 1970	5.5%	29.5%	52.4%
Dec 1973-Sept 1974	10.6	35.9	47.9
Apr 2000-Sept 2002	1.1	44.8	81.4
<b>Average</b>	<b>5.8</b>	<b>36.7</b>	<b>60.6</b>

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