Chris Horan, Financial Advisor

January, 2002

Chris Horan, CFP, RFP
Senior Financial Advisor
Assante Capital Management Ltd.
1100-320 Bay St. Toronto, Ontario
M5H 4A6

Telephone: (416) 216-6500
Toll Free: (800) 565-4605
Email: choran@assante.com

Article Background

This essay was originally published in January 2002.

Referrals

The primary way my business grows is when clients and business associates refer their family and friends to me. I am very grateful to be directly responsible for a little over $50 million, on behalf of about 180 families. It is a privilege to manage your assets – thank you very much

If you notice someone who you feel might benefit from good investment advice, please have them call me. I've included a business card. Or, if you prefer, I can call or write to arrange an introductory appointment.

If you know someone who might be interested in receiving my newsletter, just call or email my office and we'll be pleased to put them on the list.

On Bear Markets

This essay is about bear markets, because like many things in life, when you know about them, they're easier to handle.

We will see that bear markets happen quite frequently, and although they may be fearsome, to a wise investor they are simply part of the normal ebb and flow of long term progress.

The years 2000 and 2001 will be seen as one of the great bear markets of investment history. On September 21, 2001, the S&P 500 Index, a broad representation of the 500 largest companies in the US, reached a low of 944, which is about 37% below its closing high reached on March 24, 2000, almost 18 months before. The TSE 300 declined about 43% over the same period. Both indexes were back to where they were almost *4 years* ago. This decline in stock prices is the second deepest, and by only 18 days, the 3rd longest bear market since WWII.

The destruction of wealth worldwide since the highs of March 2000, estimated at US $10 trillion, is greater than an entire year's GDP of the United States. It has been concentrated in the so-called high-technology sectors of the equity markets, because they were spectacularly overvalued and had the farthest to fall (as analyzed in this newsletter).

This bear market completes the cycle of greed and then fear that began with the incredible dot.com bubble in late 1998 and ended on September 24, as these things always do, with 'weeping and gnashing of teeth'. (See sidebar on p2 for a true life story)

However, history tells us that bear markets (declines of greater than 20%) are actually quite common. Below is a table of the bear markets since WWII.

For those purists who notice that the 1956 and 1998 declines weren't quite 20%, I respectfully submit that those declines met the most important criteria (the '98 one for sure because I saw it): they terrified investors.

The Asian currency crisis and the Russian debt default knocked 30% off the TSE 300 in less that 5 months. Many terrified investors (fortunately *not* clients of mine) liquidated their long-term investments in fear in the autumn of 1998 at what turned out to be the bottom of the market.

These urgent liquidations, known by experienced investors as *capitulation*, are the hallmark of a bear market bottom. But I go too quickly.

Back to the table of bear markets. First,

Bull Market Top	Bear Market Bottom	# Days Duration	% Decline in S&P 500
5/29/46	5/17/47	353	-23.2%
4/06/56	10/22/57	564	-19.4%
12/13/61	6/26/62	195	-27.1%
2/09/66	10/07/66	240	-25.2%
12/03/68	5/26/70	539	-35.9%
1/11/73	12/06/74	694	-45.1%
9/21/76	2/28/78	525	-26.9%
4/27/81	8/12/82	472	-24.1%
8/25/87	10/19/87	55	-36.1%
7/16/90	10/11/90	87	-21.2%
7/17/98	8/31/98	45	-19.3%
3/24/00	9/21/01	546	-36.8

Source: Nick Murray, Excellent Investment Advisor

Fool's Gold

Sometimes I am not able to help my clients achieve their goals, because they choose not to listen. This true story illustrates the terrible price to be paid for greed in a bear market.

A 40 year old physician and his wife, a successful business owner, had experienced an average 11%/yr return as my clients over three years to March 2000, the peak of the tech craze. However, their Optima Strategy portfolio, had no tech stocks, and had 'only' a 4% return in the third year. Her father, looking over her shoulder, convinced her that their returns "could be better" with stocks like JDS Uniphase and Nortel Networks.

I spent hours with them, including her father, explaining the views that you have read in these pages over the years. But to no avail. So they left me in the summer of 2000 for her father's broker, put the bulk of their assets into tech stocks and turned $1.2 million into less than $200,000, a loss of over $1 million.

Now they want to sue the broker.

I use the term 'loss' intentionally here to differentiate it from normal market volatility, because the highs of many of these stocks will likely never be seen again. For Nortel Networks to get from its price today of $11 to its March 2000 high of $122 will require a return of over 27% per year for more than 10 years. It just isn't likely.

On Bear Markets cont'd

bear markets have happened now 12 times in the 56 years since the Second World War. That is <u>not</u> the same as once every 4 ½ years, but that's a good way to think about it. Second, if the smallest bear market is a drop of 20%, and the largest was about 45% (in '73 – '74), then you could say a typical bear market is a drop of about 30%.

So there you are: every 5 years or so, stocks as a group decline by 30% or so, taking somewhere between a few months and a couple of years to drop. They then recover over a similarly unpredictable period, before going on to new heights.

Now think about this: the return from stocks in the US since 1925, according to Ibbottson, the definitive database, is about 12% per year. OK, so if stocks decline by 30% or so every five years or so, then the simple math shows that in a typical bear market you give up maybe 3 years' returns, before recovering and going on to new heights.

Why do people capitulate and sell at the bottom? Because bear markets *are* ugly. It is definitely not a pleasant thing to watch your portfolio decline in market value, or even just generate a low return for several years, while the media screams daily about how your entire investment strategy is wrong, and how green the grass is on some other hill.

You would not be human if you did not feel at least some urge to liquidate your long-term investments and sit in GICs until the storm blew over. Or worse, switch to greener grass. To a neophyte investor, the temptation to sell an investment that seems to have performed poorly is one of the most powerful urges known to humankind.

So if you are looking at your portfolio saying 'It hasn't done much over the last few years'; you might be right – it may not have. But as I've shown above, it is normal to have performance that seems 'lousy'. And if it's normal then it ain't broken, and if it ain't broken, then don't fix it.

Why not switch out and avoid the mess? Because attempting to switch investments has been shown time and again to be doomed to failure. The markets are simply too capricious for anyone to be able to time their exit and subsequent reentry profitably. There is no credible person who has been able to do it. (Not only that, but *all* of the world's best investors agree that it can't be done – so who are we to argue?)

But the best thing is, you don't need to switch around to be a successful investor. You do need patience.

The latest evidence: world stock markets gained more than 9% in the 4th quarter of 2001. During this time, Canadian investors poured more than C$50 billion into money market funds, according to the Investment Funds Institute of Canada, hoping to wait out the latest storm. Instead they missed out on the gains.

A longer term example: an investment of $10,000 in the Trimark Canadian Fund at its inception in September 1981 would have grown to more than $109,000 by the end of 2001 (after fees and before taxes). Has this been an excellent investment? Of course it has. The average annual return is over 12%. Would you like to have owned this fund since 1981? Of course you would. This fund's 10 year return handily beats the TSE and is within a hair of top quartile, according to Bell Charts, a performance measurement firm.

Yet this fund has had some mediocre performance, and some terrifying performance. For example, it lost over 22% of its value in the last 3 months of 1987. It lost 18% of its value in 1998. It had a zero return over 2 years in 1997 and 1998. In fact, the fund was either 3rd or 4th quartile –the bottom of the heap – four years of the last ten. Investors pulled out more than $1 billion, almost half the assets of the fund, during 1998, amidst cries that Trimark had lost their touch.

Unfortunately for them, they pulled out just in time for the rebound: the fund posted returns of over 16% in each of 1999 and 2000.

So the question is, why do we care how much it drops in a bad year, if 10 or 20 years down the road it could be ten*fold* higher?

A bear market is like a walk in my garden in February. I'd swear that there's nothing alive, and it seems like nothing will ever grow again. But, having seen the miracle of springtime more than 40 times now, I am quite confident that by the middle of April, (OK May), things will be humming along again.

I have seen this bear market wheel come around now 5 times in 20 years. And I've learned that the best time to accumulate assets is when prices are low. And prices are low when things don't look so good. It can't be any other way.

Here's what I have done to have my clients ready for a bear market:

1. Your portfolio is balanced across markets and countries to mitigate the impact of a bad market in one.

2. We use seasoned professional money managers who know to avoid fads and search for bargains.

3. We hold bonds in many accounts to reduce the volatility of stocks to a level that is appropriate to the client's plan.

4. Clients all know that I do not pretend to avoid down markets. I do not pretend to produce positive returns each year. So they shouldn't be surprised when down markets occur.

5. When we do get a low return, we do not let it tempt us to do something stupid. We accept bear markets as the price we pay for expected long term returns. We focus on the great things to come in the future.

And finally to my last point. Bear markets are times of opportunity. Inexperienced investors are swayed by the mindless Chicken Little media blathering on about falling skies. They despondently sell out even their good long-term investments at fire sale prices, driving prices lower. These foolish souls sell out to wise investors, coached by experienced advisors, who patiently accumulate excellent investments according to their lifetime plan.

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