January 25, 2008

Note

RE: Time is All You Need

The past few months have been hard, particularly for clients going through their first Correction with us. However, Corrections, defined as 10% or greater market declines, occur with more regularity than many investors realize. The one we're in the midst of now is the 10th Correction since 1980, so roughly one-third of the years over this time span had one. Each big sell-off triggered a Recession concern, though only four actually led to one. A review of the historical evidence will help clarify the poorly understood investment implications of a Correction.

Recession		Performance		
Start	End	Early	Late	Total
Jan-80	Jul-80	-12.1%	22.9%	16.0%
Jul-81	Nov-82	-16.7%	33.2%	10.9%
Jul-90	Mar-91	-16.4%	28.3%	7.4%
Mar-01	Nov-01	-15.8%	10.4%	-7.0%*

* Dot-Com Bubble Burst Era

Corrections associated with Recessions have followed a remarkably consistent pattern, with 10%+ market declines in the early stages followed by sharp recoveries during the final few months. Surprisingly, overall returns are not only positive during Recessions, but significantly so. There have been 42 recessionary months since 1980 and the average annualized return of the market over those 42 months has been +9.6%. While that's somewhat less than average, our instinctive fear of a Recession's impact on our equity investments is clearly overblown.

Not counting the present one, there were five other Corrections since 1980 that did not lead to a Recession. With the exception of the Aug-00 to Nov-00 pullback (-16.0%), each followed the same pattern with a sizeable subsequent recovery. The most recent of these ended Sep-02, which was the last double-digit declining month that sparked similar "the sky is falling" jitters. We responded to that event with a Note very much like this one that concluded,

> *"…few can today imagine the magnitude and swiftness of the likely market rebound ahead."*

That recovery began the following month and subsequent 1-, 2-, 3-, 4- and 5-year returns from Sep-02 were 26%, 45%, 66%, 84% and 115% respectively.

On a personal note, my first market "test" was the greatest Correction of them all during this period – the Crash of '87. Imagine the poor soul who entered the market just before that event and then immediately lost 30% of their account value. Now imagine further that he/she stayed the course and has just suffered this latest blow. Despite this awful timing and measuring Peak to Trough, that account would have grown more than five-fold and had an average annualized return of 9.5%. Even with bad timing, time is all you need.

Keep the faith!

Lowell