

## First Quarter 2009 – The Quickest Bull in 70 Years

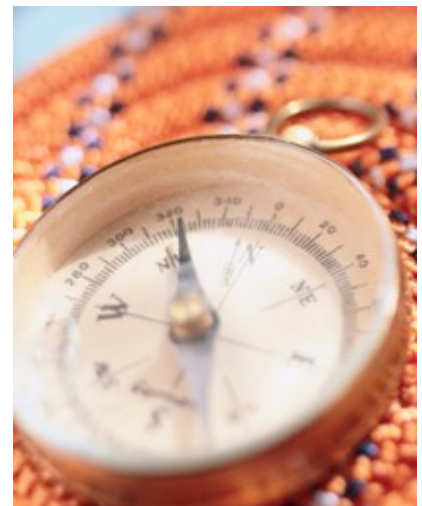
The first quarter of 2009 was another tumultuous period for the financial markets, but we just experienced the quickest bull market in 70 years during the first quarter. Although the S&P 500 Index did decline by 11% during the quarter, it rose 23% between March 9<sup>th</sup> and March 26<sup>th</sup>. This 13-trading day rise makes it the fastest bull market (defined by an increase of 20% or more) since 1938. If we can break records on the downside, why not break a few on the upside too! (We realize that this may be little consolation to many investors at this point.)

Nevertheless, therein lies a lesson for all investors. **One must be invested in the markets (stock and bond) all the time to enjoy the positive returns, whenever they do come.** And, since no one can consistently determine which days of the year are going to be worth investing in, one must be invested in all days of the year. While one might be able to correctly guess (and only with hindsight know) which few days it wasn't worth investing, we have never met or read about anyone who has been able to achieve any sort of investment success by consistently predicting the future.

Some people make a name for themselves by successfully predicting one or two events, but they too, eventually become average like the rest of us. None of the successful investors we know or have read about have ever said that their secret for success was their ability to predict the future. Even Warren Buffett, the "Oracle of Omaha" and whom many consider to be one of the greatest investors, does not generate his results by guessing the future short-term direction of financial markets.

Unfortunately, with a strategy of remaining fully invested for all 365 days of the year there will be times when it is not very rewarding and sometimes quite painful. For example, the last six quarters have all been negative ones for U.S. large company stocks. During times like these it is quite natural to question such a strategy.

An April 8<sup>th</sup> *Wall Street Journal* article titled "More Investors Say Bye-Bye to Buy-and-Hold" chronicled the thoughts of some investors who have simply given up on "buying and holding" their investments. Many of them are now favoring "opportunistic trading" (a.k.a. market timing) strategies to recoup their losses. One man, who "after watching his investments fall by about 50% last year," started trading individual stocks and options full-time last fall. He stated that he, "could no longer stomach it – watching my money disappear. For right now it's a trader's market. Until I get the sense that the market is on the rise, I generally don't plan on doing any buying and holding – not for the long term."



While many may echo those same sentiments, we are not convinced that pursuing an opportunistic trading strategy is the answer. Their strategy's success is predicated on two key factors. First, one must correctly and consistently predict the future. Short of being able to "see into the future," successful

opportunistic trading or market timing strategies require one to get the preponderance of their “guesses” right. One has to buy at the right time and sell at the right time. Getting just one side of the trade right is not enough. Buying at the right price doesn’t get you far, if you can’t sell at the right time. And selling at the right time won’t get you far if you don’t buy at the right price. It is a tall order to do this consistently.

Second is the ability to control one’s own emotions when investing. In fact, numerous studies have shown that investors often buy at the wrong time (too high) and sell at the wrong time (too low). According to an on-going study of mutual fund investors’ actual returns over a twenty year period by Dalbar Inc., this behavior has been very costly for investors. **From 1989 thru 2008, investors’ actual returns underperformed the same mutual funds they invested in by 6.5% per year.** This is a staggering difference and it shows that investors own behavior is the biggest culprit in causing poor results.

Another man who was interviewed for the *Wall Street Journal* article stated that “when I was younger, I banked on the fact that over time, that stocks will go up, and that if you dollar-cost average, you’ll be fine. But, my time horizon is getting shorter – and when you see your 401K get chopped in half, I decided I needed to take the reins.”

By “taking the reins” we fear this investor could make the situation worse for himself in several ways. First, if he feels the need to recoup losses quickly, he might take on even more investment risk (perhaps by taking concentrated positions in just a few high conviction stocks). A concentrated portfolio of any kind is always risky, especially during a time when the credit markets are seizing up, the government is taking unprecedented action, and during high volatility in the stock market. A strategy of taking on more risk during a time of heightened risk is extremely risky!

Second, the investor might fall into the “paralysis trap.” This can occur when the pain and sleepless nights after a big market decline leaves someone feeling too terrified to act at all. Perhaps the investor has sold all of his investments and is holding cash waiting for better days ahead. According to the *Wall Street Journal*, psychological studies show that people tend to rely too heavily on what has happened in the recent past when it comes to predicting the future. The challenge here is that while the investor waits for better times, the markets may have already delivered a good portion of the recovery and the investor misses out on a good portion of the opportunity to recover losses.



At Madison Wealth Management, **we advocate that your portfolio serves you, not the other way around.** This doesn’t mean blindly following a “buy-and-hold” strategy. Instead it means following a strategy that is designed to deliver the results you are looking for, with the greatest probability for success and within the boundaries you set. And it doesn’t mean that the strategy should never change, but the changes should not be dictated by what may happen in the financial markets today or tomorrow. Changes to your investment strategy should be driven by your changing needs, plans, goals and dreams.

*“A few weeks ago, I panicked again and moved another hefty chunk out of the market. The Dow was then trading at 7,500; now it’s approaching 6,500. I fully expect to panic again at 6,000, probably at 5,000, and might even get in a bit of late-in-the-day panicking at 4,000. Tentatively, I am drawing the line in the sand at the crucial watershed of Dow 3,000, because any hysterical selling beyond that point would be anti-American and counterproductive.”*

*Joe Queenan, humorist and author*