

Bear Market Survival Guide - 2008

1. Focus on what is important and knowable. During times of stress focus on the things you can control in your life. For example, you can control how much you spend and save, how you allocate your time among family and friends, and the choices you make regarding your health. You cannot control what the markets do, where the economy goes, the level of interest rates or what actions the government takes. Over time the things that you can control actually have a greater impact on your long-term financial success and happiness than those that you cannot control.
2. Engage in healthy investor behavior. Don't let the market's actions drive your actions. If no one is forcing you to do anything, then taking action for action's sake may not be the best. An analogy for this might be flying in an airplane: When the airplane hits heavy turbulence, don't jump out of the plane; instead rely on the experience and judgment of the pilots to see you through safely. That, too, is our job.
3. Don't put your "head in the sand." Be aware of your financial situation, but don't obsess over it. Consider the things that might cause you to need to change your financial and investment plan. For example, a job change or a reduction in income means that your financial plan needs to be updated and might require adjustments to your investment plan. Let us know and we will work with you to determine a plan of action.
4. Take only the risks that you need to. Financial planning will help determine how much risk you need to take to meet your life long goals. Generally, a certain amount of market risk is required and is not a bad thing. Other risks, such as holding onto too much of a single stock or type of investment is a risk that most people do not need to take. In this, case take immediate steps to reduce the risk.
5. Fear is as contagious as the flu. Take similar action to quarantine yourself from fear as you would from someone who has the flu. Tear yourself away from the computer or television; do something to get your mind off what stocks are doing during market hours. Don't let your emotions be held hostage to the actions of the roughly 100 million other people who compose the collective actions of the market. You need not be miserable just because they are.
6. Be patient. Avoid projecting current conditions endlessly into the future. Allow that there is a lot of uncertainty about how the government's rescue plan and other actions will work out. Understand that when you sense that you have a lack of control you're much more likely to accept explanations and seeing patterns that aren't necessarily there. The best way to cope with a lack of control is to control how you respond.
7. Don't give in to the pessimists. People who are bearish tend to sound smarter than those who sound an optimistic tone. After all, how can anyone be optimistic about anything when the financial markets are apparently collapsing around them? Don't they see how bad things are? Fear increases pessimism. Investors who abandon a sensible wealth-building strategy just because it is not generating short-term results, almost without fail, give up on it at precisely the wrong time.

8. During periods of such dislocation prices and value separate – prices lose their information content. Prices of stocks and bonds are set in auction markets. Auctions function well in normal times when buyers have good information about what they are buying and access to capital. Sometimes sellers are forced to sell an asset, so such a seller may not be price sensitive. Just getting rid of the asset becomes the most important goal. Occasionally auction markets cease to function properly and prices of assets that do sell no longer tell much about their inherent value. We are now in such a time. Willing and forced asset sales have lowered almost all asset prices with the exception of U.S. Treasury Notes and Bonds. This will be temporary.
9. Look for the opportunity. Bear markets are difficult to stomach, but for investors they can offer tremendous opportunities. As Shelby Davis, whose firm manages the Selected American Fund, has often remarked, “people make the bulk of their money investing during a bear market, they just don't know it at the time.” Investments made during times of great distress often produce the best results over time. The reality is that lower prices increase future returns. The lower prices go, the higher future returns will be.
10. Diversification works. Sometimes diversification does not appear to work as almost all assets can go down at once during a period of crisis. The power of diversification is that it works over time, not at points in time.
11. Financial companies are important. Right now many investors are gripped with fear from the worst-case scenario of a collapse in the global banking system. Do you really believe that the global banking system will disintegrate? The reality is that financial services are a non-obsolete business – everyone needs financial services like banking, insurance and investment management. Even if some of today's players disappear, others will emerge to take their place.
12. In times of crisis, those with psychological fortitude discover opportunities that most people miss. Most of the world sees a Wall Street meltdown. Some, like Warren Buffett take the opportunity to deploy billions from his cash hoard. They're all *seeing* the same thing, but they're *reacting* differently based on different visions of the future.
13. There is lots of dry powder. During a crisis, the saying goes that “cash is king” and there is more cash out there than you might think. American households have \$7.5 trillion of cash sitting in checking, saving and money market fund accounts. They have another \$4.1 trillion stashed in Treasury bonds. In addition many corporations and investment funds are holding large amounts of cash. At some point, this cash has the potential to be a tremendous force for stabilizing the economy, a source of funds for lending, and for buying stocks and bonds.
14. There will be better days ahead. Eventually, the global financial system will be put back together again and economic growth will continue. Consider the powerful force of the rise of the global middle class – 3 billion people have now entered the world's economic system. And, they all want the life that we have. This is a very powerful long-term force that will likely sustain global growth for decades to come.