

## Is It Different This Time?

With the reality of a recession and a bear market firmly established, many are wondering if the current economic challenges are different from those faced in the past. The best approach in addressing this question is to examine previous periods that are comparable with the current situation. The following pages will discuss historical bear markets from a statistical viewpoint and from the human perspective by relating to the events and emotions of each time period. In our opinion, the current bear market is not materially different from prior bear markets.

The table below illustrates the last five bear markets in the S&P 500 over the past forty years.

### Historical Bear Markets Over the Last 40 Years (% Price Return of the S&P 500)

Bear Market		Duration (in months)	Magnitude	Returns from Bottom		
Peak	Trough			1 Year	2 Years	3 Years
11/29/68	5/26/70	18.1	-36.1%	43.7%	59.7%	55.8%
1/11/73	10/3/74	21.0	-48.2%	38.0%	67.0%	55.3%
11/28/80	8/12/82	20.7	-27.1%	58.3%	61.5%	83.2%
7/16/90	10/11/90	2.9	-19.9%	29.1%	37.9%	56.0%
3/24/00	10/9/02	30.5	-49.1%	33.7%	44.5%	52.9%
<b>Averages</b>		<b>18.6</b>	<b>-36.1%</b>	<b>40.6%</b>	<b>54.1%</b>	<b>60.6%</b>

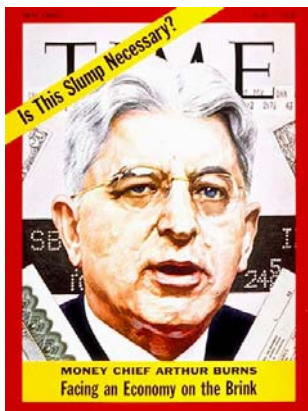
Source: WSJ Market Data

As is evident, the past has delivered a number of ugly bear markets. For instance, during the 1968-70 bear market the S&P 500 fell 36.1% in 18.1 months. Only three years later, the 1973-74 bear market delivered a 48.2% decline in 21 months. More recently, the 2000-02 bear market saw a negative 49.1% return spanning 30.5 months. On average, these bear markets fell 36.1% from peak to trough and lasted 18.6 months.

How does the current bear market compare? It began 10/9/07 when the S&P 500 peaked at 1565 (closing price). The trough may have been on 3/3/09 with a low 696, but it is still

too early to tell with certainty. Using 696 as the low, the S&P 500 has experienced a 55.5% drop over almost 17 months. While the current bear market has been severe, it is not outside the tracks in either duration or magnitude of past bear markets. This holds true even if we test these lows, as such an event would most likely just elongate the current bear market.

In an effort to place these statistics in historical context, the following summarizes each bear market and the challenges that were faced at the time. Time Magazine has proven to be a good gauge of the public psyche over the decades. Below are relevant magazine covers that depict the frame of mind during each of these bear markets.



1968-1970: After taking office in 1969, Nixon battles inflation by tightened money supply in the face of a recession. Cash and credit dry up, along with consumer demand, as interest rates soar and the economy slows. Home buyers are denied mortgages, the price of household goods skyrockets, unemployment climbs and the Vietnam War wages on. All of this was happening on the heels of the assassination of Martin Luther King, Jr. and the race riots it sparked. The S&P 500 drops 36.1 % in 18.1 months.

Cover Story: *“Facing an Economy on the Brink”* - 6/1/70



1973-1974: War in the Middle East leads to the oil embargo and the energy crisis of 1973. Watergate claims the Nixon presidency and GE cuts 50% of their workforce in 1974. Americans fear that US economic and political power is waning. Unemployment rises while consumer confidence tanks with the auto and homebuilding industries. President Ford fights inflation with tight budget and monetary policies, leading to decreased consumer demand. Air travel drops and crime spikes. The public worries another Great Depression is upon them. The S&P 500 drops 48.2% in 21 months.

Cover Story: *“The Economy: The Big Headache”* – 9/9/74



1980-1982: The US bails out Chrysler in 1979. In 1980, a second oil crisis strikes following the Iranian Revolution. Feverish inflation, high energy costs and slumping productivity reportedly threaten the foundation of capitalism and democratic society. The American Dream seems out of reach with over 17% mortgage rates. In 1981 the pros and cons of Reagan’s supply side economic policies are debated as a global recession is in the making. The US is losing the arms race as the USSR’s nuclear stockpile swells. The S&P 500 drops 27.1% in 20.7 months.

Cover Story: *“Is Capitalism Working?”* – 4/21/80



1990: The Berlin Wall falls in 1989, but the skies darken as Iraq invades Kuwait. The US's eight year economic expansion ends. Rising oil prices stoke inflationary fears and unemployment rises. Anxiety rules while global economies slow. A credit crunch ensues as banks buckle down after the boom times of the 1980's. Rockefeller Center is purchased by a Japanese real estate company and the US government is on the hook for hundreds of billions as a result of the Savings & Loans bailout. The S&P 500 drops 19.9% in under 3 months.

Cover Story: *High Anxiety: Looming Recession, government paralysis and the threat of war are giving Americans a case of the jitters* – 10/15/90



2000-2002: On the heels of the biggest expansion in US history, the tech bubble bursts, the “New Economy” buckles, the World Trade Centers fall and the US is on the brink of war. Capital investment plummets and companies cut costs with massive layoffs. The corporate scandals of Enron, Tyco International and WorldCom rattle the collective confidence of investors and the public. The S&P 500 declines 49.1% over 30.5 months.

Cover Story: *“How to Survive the Slump”* – 1/8/01

Currently, the global community faces many challenges that have been faced before, along with many new ones. This bear market will likely be remembered for the sub-prime crisis, the TARP funds, the stimulus package, the remaking of Wall Street, rising unemployment and war in the Middle East. It will likely go down in history as a time of general anxiety and malaise. Sound familiar? This bear market only feels different because it is happening *now* and it is happening *to us*. Additionally we each have more at stake than we did 20 or 30 years ago. From the statistical and human perspectives, it is not materially different this time.

### **The Good News**

With the recent drop in the S&P 500 in historical context, it is logical to examine the recoveries after these bear markets. As the table on page one demonstrates, past bear markets experienced significant recoveries after establishing troughs. A year after the 1973-74 bear market bottom, the S&P 500 was up 38.0%. Two years later it was up 67.0% from the lows. After the 2000-02 bear market, the S&P 500 rallied 33.7% in the first year from the trough and was up 44.5% two years later. Each of these five bear markets had comparable recoveries. On average, the S&P 500 managed a 40.6% return one year after the low, a return of 54.1% two years later, and a return of 60.6% three years later. It is also noteworthy that the majority of the upward progress occurs within the first year of the recovery. As the excerpts above indicate, each of these recoveries came in the face of penetrating anxiety, not unlike what we are experiencing now. While history does not necessarily repeat itself, the probability for a significant recovery over the next 1-3 years is high.

## More Good News

- Cash Levels - Recent statistics indicate there is approximately \$3.9 trillion in money market funds. This cash will not stay on the sidelines forever. Over time, it will flow into the global equity markets and help establish the foundation for a significant recovery.
- Alternative Investments - The promise of hedge funds, in particular, faded in 2008 as many reported significant negative performance, redemption requests were denied and internal hedge funds helped take down major Wall Street firms. It is likely the demand for more liquid investments such as stocks and bonds will increase as investors, institutions, foundations and endowments begin to shift their portfolios out of alternative strategies into more liquid investments.
- The Market Moves Ahead of the Economy - The market anticipates economic conditions six to nine months in advance. The market will anticipate a recovery and make significant progress prior to the economy turning around. In the months ahead, expect terrible economic reports and earnings announcements as the market recovery quietly takes root in the background.
- Consolidation - Chapter 11 bankruptcy filings have claimed household names such as Circuit City, Tribune Co. and Nortel Networks. While the media will continue to report these stories in fantastic fashion, it is important to realize that such filings are to be expected during an economic contraction. Additionally, the low market valuations of certain companies make them prime merger targets. Consolidation and retrenchment will claim the weak as they disappear or are folded into other companies, making the strong stronger. These are necessary steps as the economy expunges the excesses of the last economic cycle and begins to establish a foundation for new growth.

## Summary

History tells us that the markets will recover and those with patience and fortitude will be rewarded. Furthermore, the cyclical nature of global economies suggests that it is only a matter of time before better conditions are upon us. From an analytical perspective, the current bear market is not materially different from what we have experienced in the past. Rest assured that things will get better. We have been working tirelessly to learn the lessons from past bear markets and their recoveries. Additionally, we continue to innovate so your portfolio participates in the anticipated recovery.



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