

Thoughts & Comments

December 2008

Losing Money

Over the past few months, I was asked a few times how much I had lost in the market decline. My answer was always the same, nothing. It was not that my portfolio had not declined in market value. Just like most everyone else's, it has. Instead, it was that I do not look at it as a permanent loss, but rather as a temporary decline in market value.

In a general sense, it seems to me that there are only three ways to lose money in the stock or bond market:

1. Be narrow in investment selection. For example, think of someone who was invested exclusively in Enron. It may be true that the narrower the investment selection, the greater the potential return. However, it is probably also true that the narrower the investment selection, the greater the potential risk, which includes the risk of losing the entire investment.
2. Leverage your investments or use a margin account to accelerate profits. This works great when markets increase, but has the potential to negate the entire investment in a declining market, especially a market decline such as we have just experienced, when almost all asset classes declined in value.
 - Though it is not often discussed, in the 1920's leading up to the crash of 1929, investors could leverage stocks at ten cents on the dollar. This means that \$10,000 of cash could buy \$100,000 of stocks. If the stocks increased, profits accelerated. However, if stocks decreased, as they did in 1929, investors were forced to sell quickly in order to pay off debt.
 - This deleveraging also occurred for hedge funds and margin accounts this past fall. Keep in mind that the more investors had to sell to pay off the debt in their accounts, the faster the markets declined. Buyers with cash stayed on the sidelines, simply waiting for the forced sale of holdings in margin accounts to pass.
3. Buy high and sell low. Though it seems obvious, many investors practice this investment strategy and achieve poor results. According to a study published by Dalbar, Inc., from 1988-2007, the S&P 500 Index averaged 11.8% annual return while the average investor averaged 4.8% annual return.
 - Investors often react emotionally to a market decline and sell at the bottom turning a paper decline in market value into a realized loss.
 - Though there are no guarantees for the future, given that the market has recovered from past declines, it makes more sense to me to take advantage of the decline as an opportunity to invest at discounted prices.

I graduated from college during the 1973-1974 recession. The oil embargo was taking place, there were lines at the gas pumps, and it was the beginning of double digit inflationary years. Though a lot of my classmates were unable to find employment for a year or two, I was fortunate to be employed professionally immediately. When the recession was over at the end of 1974, *if I had invested \$10,000, or almost the total cost of my education at that time, into a group of investment funds that tracked several major stock market indexes, the market value today, which includes the stock market decline of 2008, would be about \$297,000, or an average annual return of over 10%.*

- Note: It is not possible to invest directly into an index. The represented indexes are large cap stocks, mid cap stocks, small cap stocks and commodities. Please call or email our office for detailed information on the indexes.

Long Term Economics

Though the American economy is going through a contraction at this time, it is important to remember that each time the economy contracted in the past; it recovered and grew from there.

There has been much discussion about the current economic crisis in comparison to the Great Depression. However, it seems to me that though this is a difficult time period, there is currently no overarching comparison to the Depression. One similarity may exist though, and that is the instatement of government programs to help stimulate the economy.

- In the 1930's it was the New Deal and today it is federal bailouts. In both time periods, there was and is one primary source of funding for the government to ultimately pay for these programs: individuals and businesses paying taxes. American business has been the basis for economic growth and I believe that this will continue to be true in the future.

Global Growth

My son, Morgan, and I had an interesting experience last April. After he returned from teaching English and traveling in South America, we spent ten days on a mountain bike tour in Copper Canyon, Mexico. Copper Canyon is four times the size of the Grand Canyon and is full of spectacular scenery. Viewing the landscape and culture from a mountain bike, and in my case a very slow moving mountain bike, was a unique and amazing experience.

Parts of Copper Canyon are very remote with locals often living as they did hundreds of years ago. We stayed at two places which had great food, but no electricity. Batopilas, a town at the bottom of the Canyon where we stayed for two nights, only had three public phones for the entire city. However, though the area is still incredibly remote, I believe the overall beauty as well as the opportunities for hiking, mountain biking, cultural experience and many other possibilities will increase tourism to the area.

- There is now a train that runs through Copper Canyon where tourists can get on and off in various cities and experience the scenery, cuisine and culture of the area.
- A very narrow, steep and switchback laden dirt road, on which we biked over 50 kilometers in and out of the Canyon, is now being paved at the top and will eventually be paved all the way to the bottom. This will increase accessibility and, ultimately, tourism into the area. As tourist money comes in, other economic activity will be sparked.

As Morgan and I learned on that road, the world is not flat; however, opportunity is seeping its way into areas previously untouched by what some might see as the benefits of our modern world. Though I suspect the global economic decline has affected Copper Canyon, and with it the town of Batopilas, I also believe that in ten years economic activity and prosperity will have increased dramatically from its current level in that area. This is just one example of the global economic growth which I believe will continue to take place throughout the world.

Best Wishes for the New Year.