



Investment Insights

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Predicting the Market

One of the most widely pursued hobbies in America is betting on the outcomes of events. Be it the lottery or in sporting events, Americans are fascinated with the possibility of the big payoff for correctly forecasting the future.

This was also true in the stock market during much of the late 1990's, as investors benefited from the biggest bull market in history, which made their "bets" on stocks seem very prescient as almost all stocks rose during that period.

Now, after two and a half years of a down market, prognosticators are predicting more of the same: declines, false rallies, and low or negative returns on stocks. Much like in the late '90's, making "bets" based on this common line of thinking derived from recent experience may prove to be as flawed as the outcome of "bets" based on overly optimistic predictions of "Dow 30,000" a few years ago.

A better way to view investing and form expectations is to study long periods of history, where emotions are less relevant, and business fundamentals drive the ups and downs. Here are a couple of long-term facts about market performance that you may find interesting:

Down Followed By Up

This seems simple, but is often overlooked: down years in the markets are usually followed by up years. The US stock markets were down in 2000 and 2001, and we are in the middle of what is likely to be our third down year in a row. Reviewing Ibbotson historical data back to 1926, we find that this has not happened since 1939-40-41. In the following three years, the market was up 20%, 25%, and 20%, respectively. The only worse period was the Great Depression, when stocks declined four years in a row, followed by years with a 54%, -2%, and 48% gain. On average, after a decline lasting three years or more, the next three years produced a cumulative 100% gain in the market!

The Power of Time

Looking at the market in various timeframes also gives us a good measure of what we might expect in the future. Again using Ibbotson data going back to 1926, we find that large company stocks have risen 71% of the time, specifically 54 of the 76 one year periods through the end of 2001. Thus, the predictability of the market over a short timeframe like one year is somewhat uncertain. However, taking five- year timeframes, large company stocks have risen 91% of the time (65/72). Over ten year timeframes, the number is 97% of the time! Thus, history tells us that if you invest for a ten- year timeframe, you have come out profitable nearly every time. Focus on the long-term, and use your own investment plans as a timeframe to avoid getting caught up in the month- to- month or year- to – year fluctuations.

The Danger of Sitting on the Sidelines

One final view on the power of staying invested is the impact of missing the upswings in the market and how negative that effect can be on your returns. Looking at the five- year period ending on February 28, 2001, Standard & Poor's calculated that the average annual return of the S&P 500 index was 15.75%. However, if you had tried to time the market by moving in and out of stocks, and missed the 20 best market days over that period, your return would be only 0.27%!! This is a strong argument for staying invested and not trying to outguess the short- term trend of the market.

Although emotions in the investing world are extremely negative right now, and it feels like all hope is lost, history tells us that giving up hope at a time like this is often the worst reaction an investor can have. Always have a game plan for your investing, review it often with your investment professional, and take emotions out of the process. You will probably be a more successful investor over the long run if you follow those simple steps.

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