



# Investment Insights

Kevin Kennedy

What, me worry?

April 28, 2006

When it comes to the financial markets, there's always something to worry about. It could be interest rates, international events, or the threat of terrorism: the list of potential concerns is endless. I've been advising clients on investments and personal finance for almost two decades, spanning nearly 5000 trading days in the markets, and rarely did a day go by without some sort of rumor, concern, or words of caution being voiced for why it was a bad time to be investing. Despite the naysayer's and doom and gloom, the Dow Jones Industrial Average has risen from roughly 2,000 to over 11,000 during that 18-year span, an average annual return of almost 10%. Interestingly, over the same 18 years Alameda real estate has appreciated at about 7% per year using estimates from Zillow.com ([www.zillow.com](http://www.zillow.com)), and bonds, as measured by the Lehman Aggregate Bond Index, have averaged about 6%.

Of course, the past 18 years have seen some significant down times, most notably the recent bear market from 2000-2002 which saw the Dow decline nearly 40% from peak to trough. The past 18 years have actually seen three phases where the stock market declined 15% or more (June-October 1990, July-October 1998, and January 2000-October 2002). Realizing the solid returns over the past 18 years meant staying invested through these trying times, something many investors have found difficult if not impossible. In fact, the record for the largest outflows (withdrawals) from stock mutual funds was set in the third quarter of 2002, at the bottom of the bear market. Since that time, the Dow is up over 50%! Isn't it supposed to be "buy low, sell high"?

Today, the headlines give us many reasons to be concerned: the nuclear ambitions of Iran, skyrocketing oil and gasoline prices, rising interest rates. Will any of these issues break the back of the US economy and stock market? Is now the time to get out, put the money in the bank, and "play it safe"?

When it comes to deciding if, how, and where to invest, there are two fundamental questions you need to ask yourself: what is my goal (i.e. how much time do I have and what return do I need to generate to achieve my goal), and how much risk can I stomach (i.e. what is the maximum decline I could weather without changing my lifestyle or making a rash decision about liquidating my investments)? If you thoughtfully consider these topics before investing, you'll position yourself best to benefit from your investment plan without falling victim to the typically unprofitable game of timing moves in and out of the market.

On the issue of returns, a simple financial calculator can help you get an idea of the combination of savings and returns needed to reach a future goal (check out the Research section of my website, [www.KevinKennedyLLC.com](http://www.KevinKennedyLLC.com), for a variety of calculators).

The subject of risk is much more difficult to quantify, and many investors don't give it anywhere near the attention it deserves. Knowing your risk before you make an investment is critical to your chances of success: it establishes the possibility that you will experience ups and downs in your investments. As simple as that sounds, consider this: you might be thinking "Hey, 10% a year is pretty good, I should just put all my money in the stock market". Yet, if the market immediately experiences another (relatively common) 15% decline, you might panic, sell, and swear off stocks forever, thinking, "I sure didn't buy stocks to lose money!" Of course you didn't, but knowing the risks before you invested would have prepared you for the distinct possibility of a 15% decline at some point in time.

Do I worry about the investment markets? Isn't this government deficit/war/political scandal going to do us in? I worry about the investment markets to the same degree that I worry about living near a major fault line. I don't lay awake at night thinking about it, but I certainly have considered the risks and taken the measures that help me live with those risks. Every investment I make or recommend to clients not only acknowledges the risk, but also anticipates it and takes into account the impact that risk would have on our well being. That way, when the inevitable happens, be it the big quake or the bear market, we're prepared and positioned to survive the event. If you prepare for and anticipate risk, you'll find you're much less worried about the day-to-day worries life continually seems to provide, and you'll probably be much better off in the long run.

*Kevin Kennedy is president of Kevin Kennedy, LLC, a registered investment advisor firm in Alameda. Reach him at 510-748-1898 or [Kevin@KevinKennedyLLC.com](mailto:Kevin@KevinKennedyLLC.com). Stocks, bonds, and mutual funds involve risk, including loss of principal. Past performance is no guarantee of future results.*