

**Lessons Learned  
From the Market Downturns  
Of 2000-02 and 2007-09**

**Orange County AAll**

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# MONEY & INVESTING

## Two Strategists Expect 1,000-Point Move In the Market, but in Different Directions

### HEARD ON THE STREET

By JOHN R. DOHEMAN

Staff Reporter of THE WALL STREET JOURNAL

Morgan Stanley's market strategist Byron Wien is looking pretty good so far on his April prediction that the Dow Jones Industrial Average would begin a 1,000-point decline this year. So far, the Dow industrials have fallen 296 points from their May peak.

Now a respected rival has come forward with almost a mirror-image prediction. Edward Kerschner, PaineWebber's market strategist, has just told his firm's clients that the Dow industrials will rise about 1,000 points in the next 18 months.

Wall Street gurus often shroud their predictions in enough mist that they later can claim they were right, no matter what happens. And lately, bold market predictions have been a bit rare. But Mr. Wien and Mr. Kerschner are being unusually blunt and explicit with their 1,000-point bets. Dow investors, a lot rides on whose

### Dueling Gurus



**Edward Kerschner**  
PaineWebber

*Predicts Dow Jones industrials will rise 1,000 points*

**'WE'RE GOING TO SPEND THE**  
rest of our lives looking over our  
backs for inflation that is just not  
coming.'

**Byron Wien**  
Morgan Stanley

*Says Dow industrials are in the process of falling 1,000 points*

**'INFLATION IS NOT GOING**  
to return to 1970s levels, but  
inflation is not dead.'



**The beginning of investment  
wisdom is understanding  
that no one  
can predict the future**

# DJIA 1980-1999



# DJIA 2000 - 2010



# Nasdaq – 1998-2008



# **Dow Jones Industrial Average Annual Changes 1946 - 2009**

- Years Up - 44**
- Years Down - 20**
- Median – 10.1%**

# **Dow Jones Industrial Average**

## **Annual Changes With Dividends 1946 – 2009**

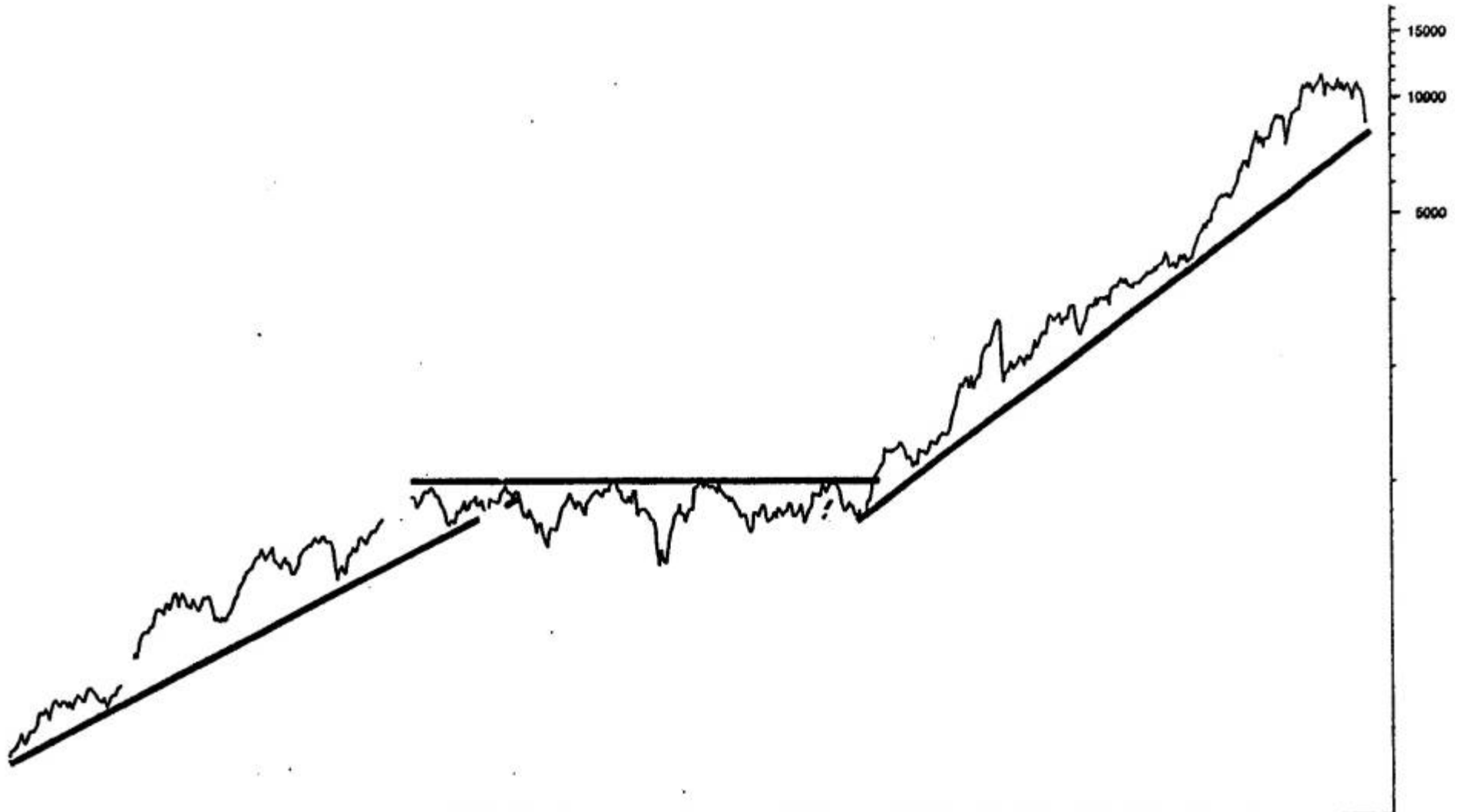
**\* Up Years - 49**

**\* Down Years - 15**



# Dow Jones Industrial Average

1950 - 2000



**What  
Happened?**

**2000 - 2002**

**Tech stock bubble**

**“dot.com” mania**

**Extreme P/E ratios**

**Infinite P/E ratios**

Take your choice . . . .

**Sub-prime loans (more later)**

**Fannie and Freddie**

**Poor regulation**

**Political pressure for home  
ownership**

**Fraud, corruption and greed**

# Lessons Learned: Strategies that Work

1. Asset allocation strategies
2. Asset protection strategies
3. Asset liquidity/time horizons
4. Regular, systematic strategies
5. *Active management strategies*
6. Cost management strategies

# Strategy # 1

## Asset Allocation

Develop an asset allocation  
plan that is right for you

(Always the single most important  
investment strategy!)

# *Asset Categories*

- **Equities**
- **Fixed Income**
- **Real Estate**
- **Commodities**
- **Precious metals**
- **Cash**

# *Long Term Investment Return*

- **Stocks** **10.2%**
- **Corp. Bonds** **7.3%**
- **Govt. Bonds** **5.9%**
- **T – Bills** **4.4%**
- **Inflation** **3.2%**

# Asset Category Returns -- 2008

Large Cap Stocks	-37.0%
Small Cap Stocks	-36.1%
Global Stocks	-44.1%
REITs	-37.1%
Corporate Bonds	+ 3.1%
Inflation Pro. Bonds	- 2.9%
Short Term Govt Bonds	+7.0%
Gold	+4.9%

# Asset Categories -- 2009

- Large Cap Stocks 26.6%
- Small Cap Stocks 28.5%
- Global Stocks 36.7%
- REITs 30.5%
- Corporate Bonds 17.1%
- Inflation Pro. Bonds 10.8%
- Short Term Govt Bonds 1.5%
- Gold 24.0%

# Asset Allocation

- You decide on your plan
- Use at least 3 of categories
- 40% to 75% in stocks
- A high risk option – everything or nothing in stocks
- Rebalance regularly

# Strategy #2

## Asset Protection

Have a wealth protection plan to limit the amount of loss you will incur on your assets

Buffet's rule #1 – “Don't lose what you already have.”

# Bear Market Downturns

<u>End Date</u>	<u>% Decline</u>
06/01/1932	-86.2%
10/03/1974	-48.2%
12/04/1987	-33.5%
10/09/2002	-49.1%
03/09/2009	-56.8%

# Recovering Losses

Portfolio Loss

Needed to

Recover

20% loss

25% gain

25% loss

33% gain

50% loss

100% gain

# **Wealth Protection Strategies – How?**

- **Have an asset allocation plan**
- **Set sell points and move them up as needed**
- **Use stop losses**
- **Sell short**
- **Buy puts**
- **Buy mutual funds that “short” stocks**

**If an investment equals 10%  
or more of your portfolio**

**You need a strategy to  
protect that investment**

# Strategy # 3

## Asset Liquidity

- Invest with *time horizons* in mind
  - Short term – buy house
  - Intermediate term – tuition
  - Long term - retire

# **Stock Price Increases**

**1926 – 2002**

**75 1-year periods**

**Up 70%**

**73 5-year periods**

**Up 89%**

**63 15-year periods**

**Up 100%**

# **Asset Classes v. Inflation (20-year periods)**

<b>Stocks</b>	<b>--</b>	<b>100%</b>
<b>Bonds</b>	<b>--</b>	<b>60%</b>
<b>T-Bills</b>	<b>--</b>	<b>42%</b>

# **Time horizon strategy**

Generally, The more years remaining in your time horizon, the higher the portion of your portfolio that should be invested in stocks

# William Bernstein's rule of thumb

No of years until you need the money x 10  
= % of money in higher risk, higher  
volatility investments like stocks

Example: You need the money in 7 years

70% of money can be in stocks and  
higher risk, higher volatility investments

If you need the money in 2 years, only 20%  
should be in such investments

# **Make Time Your Ally**

## **Have a mutual fund do it for you**

Choose your fund company

Fidelity, Vanguard

T Rowe Price, etc.

Choose your target year

2015, 2020, 2025, 2030

2035, 2040, etc.

# Strategy # 4

- Invest a major portion of your funds
  - Regularly
  - Systematically
  - With Discipline
  - (boring but profitable!)

# **“Automatic Pilot” Investing**

**Every month, quarter or  
pay period (401k, 403b)**

**Index funds**

**Exchange traded funds**

**Dividend reinvestment plans**

**Dollar averaging**

# My “automatic pilot” portfolio

- **S&P 500 Index Fund** 20%
- **Russell 2000 Index Fund** 20%
- **Global Stock Index Fund** 20%
- **Bond Index Fund** 20%
- **Real Estate Index Fund** 20%
  
- **Rebalance once a year (usually January)**

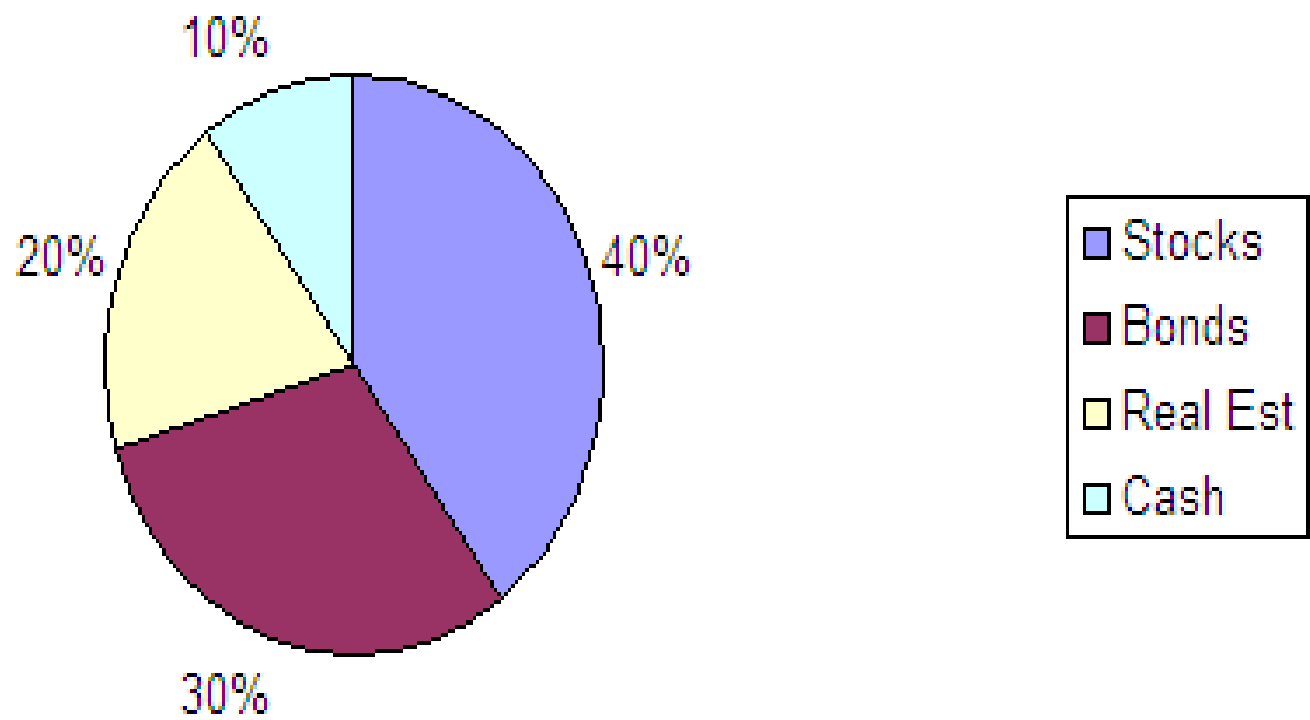
# Strategy #5

- Actively manage some portion of your portfolio
- (Some, but not all, of you will want to do this)

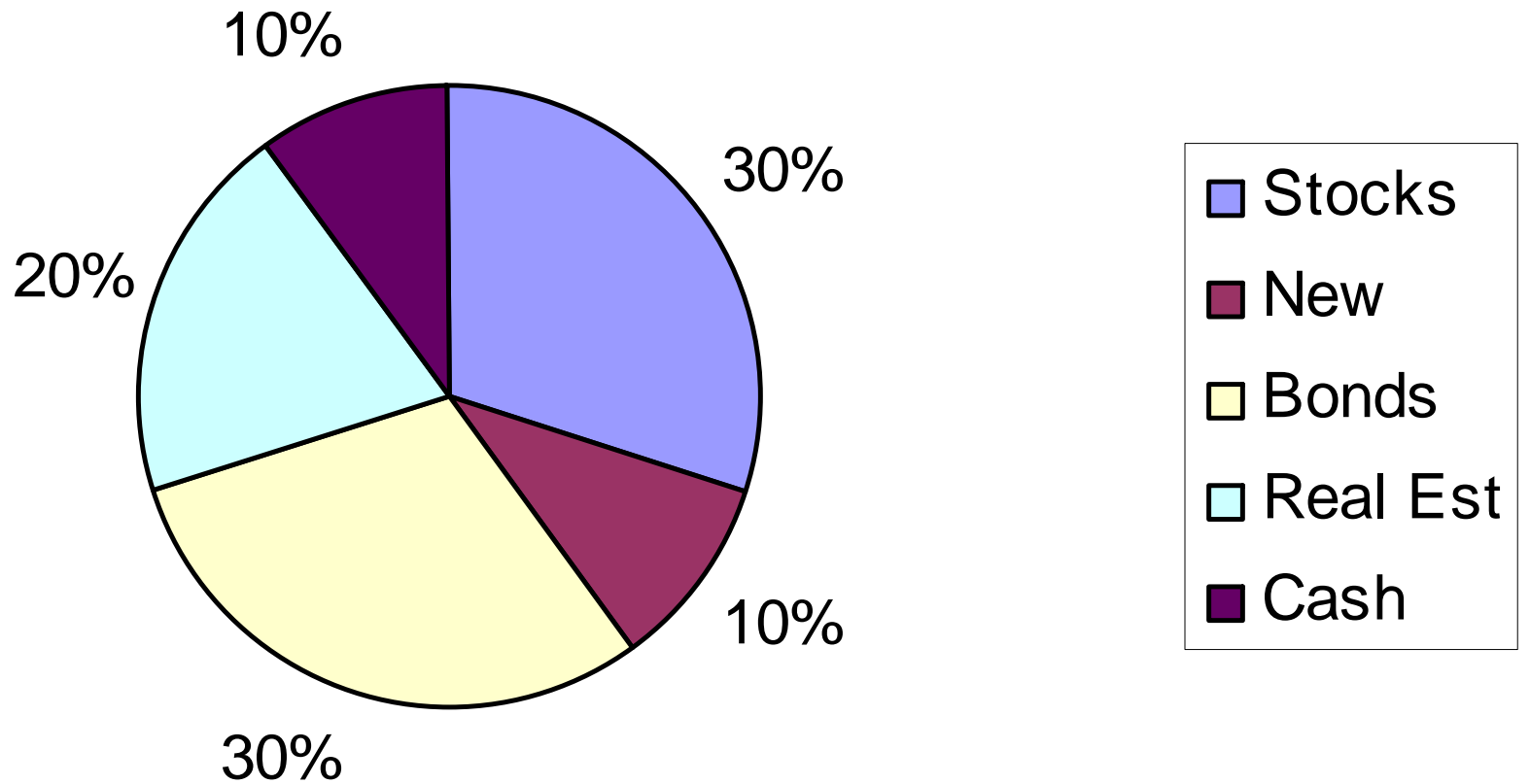
## **How much do I actively manage?**

- 1/3 ?
- 2/3 ?
- Actively manage the amount you can afford to lose without it affecting your life style

## Sue's Portfolio



# Sue's Experiment



# Strategy # 6

- Control the things that you can control

# ***Little Things Mean a Lot!***

- **Fund loads**
- **Annual expenses**
- **Tax deferrals**
- **Tax elimination**
- **Employer matches**
- **Low portfolio turnover**

# **“Load” Mutual Funds**

**“Load” = sales charge**

**Pays for sales costs**

**None of the “load” costs**

**go to improve fund  
performance**

# Annual expense ratio

**Pays for management, research**

**Closely related to performance**

**Higher expenses, lower return**

**Look for 1.0% or less**

**A few good ones up to 1.5%**

**Index funds .5% or less (some at  
.2%)**

**Many ETFs at .3% or less**

# Look for expense ratios:

- In the fund's prospectus
- At the fund's web site
- At web sites such as:
  - Morningstar, Yahoo
  - Marketwatch, Google

# Control what *YOU* can control

- Mutual fund loads
- Expense ratios
- Tax deferrals
- Tax elimination
- Employer matches
- Portfolio turnover

**“If you have an I.Q. of 150,  
sell 30 points. (To be a  
successful investor) you need  
to be intelligent. You don’t  
have to be a genius.”**

Warren Buffett

Annual shareholders’ meeting

Omaha, NE, May, 2009

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Monday of next month

Receive invoice at same time

## *To summarize*

- **Asset Allocation**
- **Asset Protection**
- **Protect liquidity with time horizons**
- **Regular, systematic investment**
- **Active management**
- **Control the little things**

# *Finally . . .*

- **Buy low !**
- **Sell high!!**

- **Thank you**

- **Most investors make profits by buying quality for the long run rather than trying to beat the market in the short run.**

**»Louis Rukeyser**

