HELM
INVESTMENT MANAGEMENT

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December 15, 2014 No. 29

THE BEARS OUT THERE

Several stock market indices hit all-time highs late last month. Six weeks earlier, those same indices were double digits down from the previous market highs. Commentary opined that September always has nasty financial weather and that we avoided a bear market for various reasons including better-than-expected third quarter earnings. Maybe so, but we metaphorically live in a financial woods and there often are bears out there.

The semi-official definition of a bear market is a 20% or greater drop from a recent high of the S&P 500 or Dow Jones industrial average. The current bull market has been running for 5.5 years. The average life of a bull run is 4 years, according to a column in *Investment News* by asset manager Mike Boyle. Unfortunately, equity market cycles can't be gamed using a calendar. In some ways, bear markets are a mirror of bull markets. Just as investors as a whole tend to shrug off bad news during a bull market, investors tend to ignore good news during a bear market. We hope our clients will avoid both ends of that spectrum when the next bear does show up and starts eating our lunches.

Helm Investment remains mostly bullish on equities, both in the U.S. and elsewhere. But bear markets typically show up with little warning. While Schwab analyst Liz Anne Saunders argues that we are merely in the middle of a long-lived bull market, respected *Financial Times* columnist John Authers is arguing that the rally since 2009 represents mostly a bull move in a longer-running bear market. Authers, citing a high long-term price-earnings ratio for stocks, warns that equity prices could see a nasty bear market before the next real bull begins its run.

When the next bear drops down on the markets, we think the downturn will be less harsh than the last two, which saw losses of 57% and 49% for the S&P 500. We don't have either the tech bubble or the housing bubble that triggered the last two bear markets. That said, we cannot predict the time, the cause, or the extent of the next bear market. We can help our clients shield themselves with asset allocation in the areas of equities, income equities (like MLPs and preferred stocks), and fixed income. We diversify across large caps, midcaps, small caps and international equities. We also advise our equity investors to "hold on," equity investors being those who have at least a three-year investment horizon. Even very long-lasting bear markets almost never keep stocks down for more than 2.5 to 3 years.

Understandably, our Helm clients would like us to get them out before things get bad and get them back in just as things turn good. We lack the exquisite timing to do those things and are skeptical that any investor has that timing except in cases of dumb luck. Moreover, we are sure that a steady course will beat trying to time the market. Here's an example of hanging in there and not trying to time the market: The last bear market ended on March 9, 2009 (based on the S&P 500). Over the following two months, Boyle notes, the S&P 500 moved up 37% and the S&P 600 (small caps) moved up 51%. Investors out of the market missed this quick move and saw only a total return of 140% for the S&P 500 versus the bull market total return of 230% from 2009 through today.

That's true in the long run as well. Missing the 20 best stock market days in the past 20 years (one day per year on average) cut your return from an average 9.3% per year to only 4.8%. Disciplined rebalancing – trimming stocks a bit during big bull runs and selling fixed income to buy stocks during bear markets – can widen that performance gap.

Both examples are important to keep in mind on bad stock market days (and there likely will be more big drops and bounces up in the coming months), since the stock market often anticipates events but not always correctly. The world's financial markets are mechanisms of anticipation: Investors buy today with a view toward what the world will look like six months ahead or more. So relax, take a deep breath, and don't let worries about a few bears out there steer you off course.