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My Stock Market Predictions

Economic academics and veterans of multiple market cycles generally agree it is difficult if not impossible to time the stock market. "Timing" means you get out befo re it goes down –at least dramatically – and then get back in to participate in the up market. Our reptile brain tempts us to "sell stocks and go to cash" before it gets too ugly and "ride this out in the safety of cash" and then our greedy nature tells us to "buy back in" when things "look better." We feel that way because somehow "it is different this time" and I "cannot afford" (either financially or emotionally) to watch my account lose value.

But before talking about investments. Let's talk about everyone's next favorite topic (just ahead of politics), the weather.

The stock market is a bit like the weather I experienced growing up in South Dakota. The weatherman on KELO in Sioux Falls often said, "If you don't like the weather at this moment, hang around, it will change." Beautiful warm sunny days would become late afternoon showers that the corn needed, only to become thunderous hail storms pounding the corn to the ground. Next comes a tornado heading straight for town, only to turn and disappear without damaging any property, followed by a glorious rainbow and a beautiful evening with burgers on the grill.

What would you think of a farmer who after reading the Farmer's Almanac decides not to plant his crops one year because the Almanac is predicting a dry year with violent, erratic weather and takes the year off? Then the next year, the Almanac is predicting a perfect growing season and states the likelihood of violent weather is highly unlikely. Is the guy farming or is he gambling?

Most of the farmers I knew growing up would plant some corn and also soy beans so if the price of one was up and the other down, at least they got a good price for one rather than putting all their eggs in one basket. In the investment world we call this diversification. Most family farmers also had some livestock…cattle, pigs and maybe sheep or chickens. Why? More diversification. If the crops were ruined by draught or hail, they could sell livestock to pay the bills and buy seed for next year's planting.

A farm family knows how much money they need from year to year. They know how many acres of grain they need to plant or cattle they need to sell to pay their bills. They also accept that they cannot predict the price of corn or cattle in the future. They do know that to an extent they can control when they sell as long as they have sufficient reserves to wait for better prices. They also know that good prices and crop yields will inevitably be followed with bad prices and high yields and then the reverse. They also know you cannot predict when good or bad will occur. In years with good crop yields and low prices, they would store some of that plentiful harvest to sell later when prices are higher (due to the next bad harvest). Sometimes, when prices are down, some smart farmers even buy grain from other farmers in order to sell it later when prices are higher (buy low to sell high). When grain prices are down often livestock prices will be higher (more diversification).

Now back to predicting the stock market. But before you try your hand at predicting the future, **<u>let's see how good you are at identifying market declines in the past.</u>**

How large was the largest decline in an all stock portfolio (70% US Stocks & 30% International) during the period of January 1, 1972 to December 2014? When did it occur? How long did it take for the market to peak and then drop all the way to the bottom? Finally, from the bottom, how long did it take to regain its previous high value?

Now, allow me to change that up a bit by using a portfolio that is 5% cash; 35% fixed income (bonds); 40% US Stocks and 20% International Stocks. Same questions: How big was largest drop? When did it happen? How long did it take for this portfolio to bottom out? How long did it take to recover to the previous high?

One more portfolio. This time 15% cash; 55% Bonds; 20% US Stocks and 10% International Stocks. How much was the biggest drop? When? How long to bottom? How long to recover?

<u>What if I make this a multiple choice exam?</u> The following charts represent four hypothetical portfolios and their ten greatest market declines over the past 43 years. Match the market declines to the following hypothetical portfolios:

___ 100% Stocks: 70% US & 30% International
___ 5% cash; 35% Bonds; 40% US Stocks; & 20% International Stocks
___ 15% cash; 55% Bonds; 20% US Stocks; & 10% Intern'l Stocks
___ 20% cash & 80% Bonds

Which market declines came from which allocation model?

Portfolio #1

Depth of Fall	Started Fall in Month / yr	Months in Fall	Months to Recover	Recovery Date
-9.20%	Jul-79	7	2	Apr-80
-5.40%	Jun-80	4	11	Sep-81
-3.90%	Jan-94	5	7	Jan-95
-3.50%	Sep-74	2	5	Apr-75
-3.30%	Jan-84	4	1	Jun-84
-3.30%	Feb-87	7	1	Oct-87
-2.90%	Apr-13	4	8	Apr-14
-2.90%	Aug-08	2	1	
-2.80%	May-03	2	4	Nov-03
-2.80%	Nov-81	1	2	Feb-82

Portfolio #2

Depth of Fall	Started Fall in Month / yr	Months in Fall	Months to Recover	Recovery Date
-14.50%	Oct-07	16	6	Aug-09
-9.30%	Jul-73	16	4	Mar-75
-7.80%	Aug-87	3	6	May-88
-7.40%	Sep-79	6	0	Mar-80
-5.00%	Mar-81	6	1	Oct-81
-4.80%	Jul-90	2	2	Nov-90
-4.10%	Jan-94	2	10	Jan-95
-3.80%	Mar-84	2	2	Jul-84
-3.70%	Dec-89	4	0	Apr-90
-3.60%	May-11	4	3	Dec-11

Portfolio #3

Depth of Fall	Started Fall in Month / yr	Months in Fall	Months to Recover	Recovery Date
-52.5%	Oct 07	16	46	Dec-12
-44.4%	Mar-00	30	39	Dec-05
-40.40%	Dec-72	21	26	Nov-76
-24.7%	Aug-87	3	13	Dec-88
-17.0%	Dec-89	9	4	Jan-91
-16.1%	Nov-80	20	3	Oct-82
-14.2%	Jun-98	2	2	Oct-98
-10.1%	Jan-80	2	1	April-80
-8.5%	Apr-84	3	0	July-84
-6.9%	Sep-79	1	2	Dec-79

Portfolio #4

Depth of Fall	Started Fall in Month / yr	Months in Fall	Months to Recover	Recovery Date
-32.00%	Nov-07	16	21	Nov-10
-22.30%	Jul-73	14	13	Oct-75
-21.50%	Aug-00	25	16	Jan-04
-15.70%	Aug-87	3	10	Sep-88
-10.10%	Apr-11	5	4	Jan-12
-9.70%	Jul-90	2	4	Jan-91
-8.50%	Mar-81	6	1	Oct-81
-8.20%	Jun-98	2	2	Oct-98
-8.20%	Jan-80	2	1	Apr-80
-6.80%	Dec-89	4	2	Jun-90

Ok…how did you do? The answers are at the end.

Congratulations if you guessed that the largest declines for three of the four allocations began near the end of 2007. However, the declines for the "great recession" which is also known as the financial collapse in 2008 – '09 ranged from 52.5% for an all equity portfolio to 14.5% for a portfolio with 30% equities.

However now it gets interesting. The ***all stock portfolio*** (chart #3) had one decline of greater than 50% which began in 2007. It experienced a 44% decline starting in March 2000 (Can you still remember the "dot.com" boom – bust? That was followed by the 9-11 terrorist attack. And don't forget the WorldCom / Enron lying cheating and stealing. These three combine for the trifecta). The next big decline was Dec of '72 ---Arab oil embargo. These are severe declines that took a long time to recover, an average of 37 months or 3 years – note Portfolio # 3.

The fourth **Top Ten** market losses for an all stock portfolio was in 1987 – do you even remember Black Monday? Please notice that the drop of 24% took only three months and then the recovery was completed in thirteen months. Short trip.

The next three "major declines" were in the teens and the last three **Top Ten** were 10% or less and were completed round trip in less than six months.

Now look at the more ***balanced portfolio of 5% cash, 35% Fixed Income, 40% US Equity and 20% International Equity.*** (chart #4). The largest top to bottom drop was 32% from the markets top in October 2007 to the bottom in March 2009, which included the financial crash of 2008. It took 21 months for this portfolio to recover, for a round trip of 37 months. The next four "disasters" were 22.3%, 21.5%, 15.7% and 10.1%. The 2011 major decline for this theoretical 60% growth and 40% defensive portfolio seemed like the next "big-one" as it was approaching. You remember the circumstances, right?

Allow me to refresh your memory. Congress and the President were playing a game of chicken over the budget and expanding the debt ceiling. The result was that for a time the Federal government went broke. National Parks were closed; Federal employees were furloughed or working without pay; and I needed to renew my passport. The bond rating service, Standard & Poor's, reduced the rating of U.S. government bonds from AAA to AA. And of course don't forget that Greece was going to default on their debt and possibly leave the European Union. Oh my gosh, it is 2008 all over again, right? So this theoretical portfolio crashes 10.1% from April through September. Then it takes four months until January of 2012 to recover. Round trip, peak to "crash" back to peak: 9 months.

Ok, I will stop now. You get my point. Attempting to time the stock market is just like gambling. Buying stocks when it "looks good" and selling stocks when things "look scary" will inevitably lower your returns long term and leave you with sleepless nights. Consider all the periods of economic boom and bust, wars and rumors of war, political insurrection, assassinations, terrorist attacks, and natural disasters and their negative impact on investments. Remember the following facts:

The Standard & Poor's Index of the 500 largest stocks has grown over my lifetime from:

- ***24.81 in October 1953***;

- 98 in 1973 (Arab oil embargo and gas lines);
- 164 in 1983 (inflation in the teens, 18% T-bills and 15% mortgage rates, Iran hostage crisis);
- 768 October 2002 (following the dot.com bust, 9-11 terrorist attack, going to war in Iraq, and WorldCom & Enron corporate lying and cheating);
- 666 March 9, 2009 (financial crisis, global recession, failure of Lehman Brothers and bailout of AIG and General Motors)
- 1,131 October 2011 (U.S. government shut down & credit downgrade, potential Greek / Italian default);
- And now after all that, the S&P500 closed at ***2,077 on Friday, August 7, 2015***.

Past performance is neither an indication of nor guarantee of future results.

Yes, I know, the world and investments are both scary places. Bad things happen….even to good people. We all need to remind ourselves that investing can be like the seasons. There are days when the weather is pleasant and comfortable and other days you may require a coat outside. Some days are sunny and warm and other days are cold and raining. Just as we need the rain to make things grow we need market declines to make investment opportunities. Most of us live in a house and own a coat because we know it will rain some days. In the same way, we adjust our investments so we don't "have" to sell stuff when markets go down --- in some cases we hold some of our investments in "defensive" investments that we hope will not go down as much as stocks so that perhaps we can buy more stocks when they are cheaper and "on sale" --- just like the farmer.

You should first have a candid conversation with yourself and ask:
- How much could my investments go down in value before I panic?
- What did I do with my investments in 2008?

The next conversation is with your investment advisor / financial planner:
- What return do I need to accomplish my financial goals?
- How much of my investments are invested for "growth" versus "defensive?"
- What are my chances of getting the return I need with my mix of growth vs. defensive?
- How long could I go before I "have to" sell some investments to pay bills or handle an emergency?

As far as predicting the stock market, good luck with that. One of my mentors early in life gave me some of the best advice. "Control the things in life you can control and then don't expend time or energy with the rest." With that in mind, answer the following:
- How much income is ideal? Then separate the "needs" from the "wants" and "wishes." Answer that question for today, then make estimates for ten and twenty years in the future.
- Are you ok with only paying for the needs in "bad times?" And waiting on the wants and wishes for better times?
- If I invest __% for growth (stocks) and __% defensively (bonds and cash), what is my probable short- and long-term rate of return?
- With that same investment mix, what will some of the potential "bad times" look like?

- How will I feel and react to these "bad times?"

The stock market is sorta like farming. Accept that good and bad happen at seemingly random times. Plan for it. Profit from it. Control what you can control. Know what you cannot control (like the weather). Then be smart about it. Keep your eyes on the horizon. Yes, there could be storm clouds in the sky and a tornado in the next county and things look scary. Yet all you get at your farm is a gentle rain that waters your corn. While next week, month or year you go to bed on a beautiful starry night and a tornado tears down the barn. When that happens, you sell some of the grain you have stored for future sale or cash the CD you have been holding for an emergency, rebuild the barn and then plant the next crop.

So finally after all these many words, my predictions:

Stocks will go up.
Then they will go down.
Then they will go back up again.

Unless:

Stocks go down first.
Then they go up.
And finally, they go up some more.
Only to go down again.

These "predictions" are the tongue-in-check musings of Fred Wollman and should not be construed to be investment advice by Voya Financial Advisors or any of their representatives. You should check with your investment professional before making any investment as well as discussing the tax impact of any investment with a tax advisor.

Answers to the Quiz:

Portfolio #1: 20% cash + 80% Bonds
Portfolio #2: 15% cash + 55% Bonds + 20% U.S. Stocks + 10% Intern'l Stocks
Portfolio #3: 100% stocks: 70% U.S. + 30 Intern'l
Portfolio #4: 5% cash + 35% Bonds + 40% U.S. Stocks + 20% Intern'l Stocks

Indices referred to include the USA T-Bill for cash, The Barclays US Aggregate Bond Index for Bonds, S&P 500 for US Stocks, MSCI EAFA for Foreign Stocks. All performance and hypothetical portfolio information come from FinaMetrica.

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