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Factors In Focus

The Most Important Lesson From The Last Seven Years

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Those who follow financial markets closely know that we reached a seven-year milestone at the end of February. For those who don't know what I'm referring to, I will present the relevant data in a table below.

Asset Class/Portfolio Mix	3/2009 to 2/2016 Annualized Return	Growth of $1
US Large Cap stocks	+17.2%	$3.04
US Large Value stocks	+19.1%	$3.40
US Small Value stocks	+18.9%	$3.36
Int'l Large Cap stocks	+9.5%	$1.88
Int'l Large Value stocks	+9.5%	$1.89
Int'l Small Value stocks	+13.7%	$2.45
Emerging Market stocks	+8.9%	$1.82
Short-Term bonds	+3.5%	$1.27
All-Stock Asset Class Mix	+16.4%	$2.89
Balanced Asset Class Mix	+11.9%	$2.20

It was this month, seven years ago, that the severe downturn in stocks that began in late-2007 finally came to an end completely unexpectedly. There were no headlines in early 2009 proclaiming that "the worst was over" or that stocks had finally fallen far enough to where it was safe to invest again.

Want a reminder of what the state of the financial markets were on the exact day the stock market bottomed—March 9, 2009? Warren Buffett told CNBC that the economy had "fallen off a cliff." If a 50%+ decline on stocks up until that point didn't scare you, Buffett certainly did.

What Should You Have Learned?

What is the *most* important lesson from the last seven years? Don't time the market? Diversify broadly? Keep costs low? Or some version of the other principles I lay out in these pages almost every month? No. They all matter, of course. But they aren't the most important.

So what is? Simply this: ***the world does not end***. It's a basic but also incredibly powerful message. As an investor, if you take catastrophe and/or armageddon off the table, you recognize that the inevitable trajectory of capitalist economies is forward and upward. "Ownership" investments in capital markets —public equities (stocks)—must eventually follow a similar path.

It's not that economies and therefore markets do not sustain periodic setbacks. Clearly they do, and as 2008 taught us, sometimes they are significant. But if you take "the world might end" off the table, then you are also admitting to yourself that these setbacks are temporary and we will eventually recover from them. This is how it has always been and 2008 did nothing to change that. In fact, it should have strengthened your resolve.

Remembering 2008

Let's consider the 2008 collapse for minute. What was the backdrop of the economic crisis and global stock market plunge? Of course, we had a classic malinvestement real estate boom fueled by a dangerously inept Federal Reserve monetary policy—they kept the Federal Funds interest rate well below the "natural" rate for years in the early-to-middle 2000s.

However, real estate prices peaked in 2006, years before the market started to decline—so there is much more to the story.

Specifically:

1. Investment banks gorged themselves on leverage to try and counteract artificially low interest rates.
2. A government-created, "big three" (Moody's, Standard & Poor's and Fitch) ratings-agency monopoly ensured that banks' levered assets were deemed "safe."
3. In late 2007, the Financial Accounting Standards Board (FASB) decided to significantly change the rules regarding how companies had to account for their assets, implementing "mark-to-market" accounting. This was a return to a policy we had not had in place since the 1930s during the Great Depression (see the connection?).
4. The greatest "phantom" destruction of corporate balance sheets in modern history due to the accounting changes and a parallel decline in stock values (incidentally, mark-to-market accounting was significantly scaled back in March 2009. Coincidence?).
5. As financial institutions inevitably began to show serious signs of distress, the government began a game of bailout roulette, picking and choosing winners and losers in an almost incomprehensible manner.
6. And when this didn't "work," we turned to massive, trillion-dollar stimulus packages (which, contrary to popular notion, did nothing to improve the economy or stem the stock market decline—stocks declined almost 30% between November of 2008 and February 2009) with obvious long-term, private sector crowding-out implications.

Optimism Pays

And yet, despite a perfect storm of public policy ineptitude (of course, there's the Hollywood "Big Short" version of history as well), global economies and certainly global capital markets have rebounded and even thrived. Some investors saw through this temporary malaise and stuck with their plans. They were handsomely rewarded. Their guiding principle was an abiding belief in the future of capitalism and capital markets. And with it, faith in the market's ability to shrug off and overcome even its most severe challenges.

Seven years later, as the table on page 1 shows, we are 100% to 200% higher than the levels we dipped to in early 2009, and this includes a full recovery from the pre-bear market levels of 2007. In every case, the riskiest and most depressed value stocks have performed even better than blue-chip market averages. Low-risk bonds have remained low risk but have also been devoid of any return.

The future will never be serene. We will always have political and economic conditions that warrant concern and fear. We will have other panics and other bear markets. But know this—*the world doesn't end*. Make this the one lesson you take from the last seven years, if you didn't believe it before. Apply it towards every disconcerting future event. You'll profit from it for the rest of your life. If you have friends or family members who cannot muster the courage and confidence to follow this belief during the darkest times, take the initiative to introduce them to a financial advisor who will remind them when it matters most.

US Large Cap stocks = DFUSX, *US Large Value stocks* = DFLVX, *US Small Value stocks* = DFSVX, *Int'l Large Cap stocks* = DFALX, *Int'l Large Value stocks* = DFIVX, *Int'l Small Value stocks* = DISVX, *Emerging Market stocks* = DFEMX, *Short-Term bonds* = DFGBX

All-Stock Asset Class Mix = 21% DFUSX, 21% DFLVX, 28% DFSVX, 18% DFIVX, 12% DISVX, rebalanced annually

Balanced Asset Class Mix = 13.5% DFUSX, 13.5% DFLVX, 18% DFSVX, 12% DFIVX, 8% DISVX, 35% DFGBX, rebalanced annually

Past performance is not a guarantee of future results. There are limitations inherent in model performance; it does not reflect trading in actual accounts and may not reflect the impact that economic and market factors may have had on an advisor's decision-making if the advisor were managing actual client money. Model performance is hypothetical and is for illustrative purposes only. Model performance shown includes reinvestment of dividends and other earnings but does not reflect the deduction of investment advisory fees or other expenses except where noted. This content is provided for informational purposes and is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, products, or services.

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