
Lessons Learned From the Stock Market Performance in 2009

Market recovered 59% of 2008's loss; equities remain best bet for long-term growth

By Bill Bender, CPA, PFS, MS

In 2009, the stock market provided us with one of the wildest rides in my lifetime. After peaking at more than 14,100 in 2007, the Dow proceeded to slide by more than 53% until it reached bottom in March 2009.

Having hit bottom, the market has since recovered by close to 59%. Do not make the mistake that a 53% decline followed by a 59% upswing gives you a net return of 6%. If you had invested \$1 million in an all equity portfolio and that portfolio lost 53%, it would have bottomed out at \$470,000. If that \$470,000 grew by 59%, the value would now be approximately \$747,300. You would still be down by approximately 25% which makes total sense since the Dow, as I write this letter, is at approximately 10,500, after having peaked at slightly more than 14,100.

What are the key lessons learned over the past year?

Buy passive index funds. *Kiplinger's Retirement Report* published in November 2009 shows that for the five years ending June 30, 2009, the S&P 500 outperformed 62.9% of all actively managed large-company stock funds. The S&P mid-cap 400 outperformed 73.4% of all midsized-company funds. With the freefall that the market suffered from September 2008 to March 2009, more journalists than ever were under the impression that active managers could have outperformed their benchmark. After all, they could have sat in larger cash positions or gotten out of the market altogether and saved themselves from some of the huge crash. In conclusion, even in times like this the index beat the majority of those who tried to time the market or purchase mispriced securities.

Know your risk tolerance. Many of our clients went through a risk/tolerance exercise and came up with the conclusion that they could suffer losses of 40% in their portfolio and sleep well at night. With the sudden decrease in the Dow Jones Industrial average between September and November 2008, many of our clients' portfolios lost approximately 25% of their value in a 90-day period. What we discovered was that many of those who thought they could lose 40% realized that when they lost 25%, they could not handle the volatility.



Each individual must realize his own willingness, need and ability to take risks. Ask yourself, when your gas light indicator goes on in your car indicating you are low on fuel, do you pull into the next gas station or do you press your luck and see how far you can go before you must fill up?

Be diversified. Diversification truly showed its worth in 2009. Our company's retirement plan shows returns from January 1, 2009, through yesterday in the amount of 32.48% for our large-cap growth stock index. Large-cap value has increased 37.03%. Small

and micro caps have returned 35.46% in 2009. Our international holdings have increased by over 40%. Emerging markets are up over 80%. If you fled to safety and put yourself predominately in fixed income, you would have been lucky to earn approximately 6% of which a good portion of those returns are the result of the lowering of interest rates. If you gravitated towards U.S. large growth companies, the ones we all recognize as household names such as Proctor & Gamble, Coca Cola, Wal-Mart, you would have earned returns of approximately 32%. Even though you may be up 32% on your large-cap holdings, that is substantially less than the 38.91% that we earned overall. Diversification does pay off. Not all of the time, but since we do not know when it will work, the prudent strategy is to stay the course and stay diversified.

Weather bear markets. Bear markets are an essential element in a never-ending cycle. Bear markets are always followed by bull markets over and over. They occur approximately every five years. There have been 13 bear markets since World War II with an average decrease of 30% each time they occur. They have been temporary interruptions of a permanent uptrend where after hitting a peak, the market falls and then sets a new high in subsequent years. If it were not for the volatility of equities, we would be stuck receiving the same return as are available on riskless treasury bills. If you are going to invest in equities, be prepared for continued volatility.

Principles to Guide Your Investing Future

Have faith in the future. If you are going to be in the stock market, you must have faith in the future of the world economy. There will continue to be new discoveries that propel worldwide economies forward. Twenty years ago computers were in their infancy, cell phones did not exist, DVD players did not exist, and what about Twitter, Facebook and all of the other Internet sites? The world is changing quickly.

You must have patience. Do not react to events of the moment, but on your lifetime goals. Warren Buffet said, "The stock market is a highly efficient mechanism for the transfer of wealth from the impatient to the patient."

Discipline. You must make decisions to keep doing the right things. When discipline fails, your plan will fail. You must have the attitude that you do not care what is working now; instead you must care about what has always worked and persist in doing the things that have most reliably always worked. This means diversification, using low-cost passive funds and adhering to your own personal risk tolerance.

Rebalance. Return your portfolio to its target diversification annually on the same day. Had you started the year with a 60% equity 40% bond portfolio, you would have ended the year 2008 with a portfolio that was more like 45% equity, 55%

fixed income. Had you removed 15% of your fixed income and put it back into equities, you would have enjoyed the over 30% return that stocks had in 2009 rather than 6% earned by fixed income this year.

In conclusion, fear and greed have always driven the stock market. When stocks are in a freefall, people cannot get out of the market fast enough. They typically sell near the low point. When stocks are on the uptrend, people cannot get in fast enough. They, in turn, buy near the high point. Our advice is to regularly make your purchases into the stock market without paying attention to the level of the Dow Jones Industrial average.

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