

# Downturn and Recovery

## – A Historical Perspective on Financial Markets

~ Janet Baccarani and Jennifer Black

The fluctuations of financial markets and the current economic climate are clearly making many investors anxious. When markets are on the way up, investors see their portfolios grow and say they are comfortable with the level of risk that investment involves. When the markets experience a downturn, the same investors realize they are not really so comfortable. This is a natural, understandable and emotional reaction to the seemingly uncontrollable changes to the value of their investment holdings. Unfortunately, acting on an emotional response can be very detrimental to an investment plan.

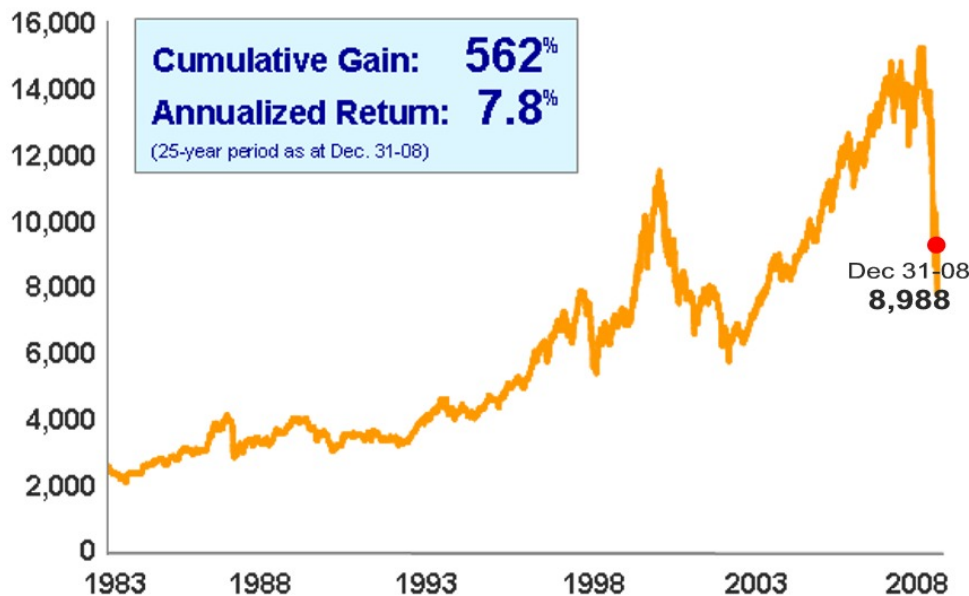
It is a fact that the stock market cycles between “bull” and “bear” markets. There is no avoiding this reality, and we have to acknowledge that it is challenging and frustrating. It is also potentially rewarding, and this is what ultimately keeps us invested. For any investor, the most difficult aspect of investing is managing the emotions that come with market highs and lows. Alternating between optimism and pessimism, confidence and fear, the natural tendency is to want to buy when feeling good, and to sell when feeling bad. The problem is that emotions trigger the wrong impulse. When the market value is rising, the impulse to buy more means you’re buying when the price is higher. When the market value goes down, the impulse to sell means you’re selling when the price is lower. Emotions trigger impulses that are completely opposite and counterproductive to the most fundamental of investment philosophies – buy low and sell high. The challenge is to control those extremes and to find an emotional balance for making the right investment decisions.

Looking at market performance from a historical perspective may help develop a better understanding of the cyclical nature of the stock market, which in turn could help you separate investment decisions from those emotional impulses. It might even help to restore your confidence.

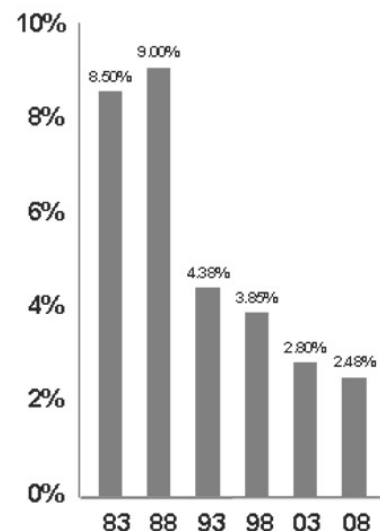
## What history has demonstrated...

### No substitute for long-term equity returns to build wealth

S&P/TSX "Total Return" (25-year period as at Dec. 31-08)



GIC Rates (5-year term)



Source: Bank of Canada  
(rates as at Dec. 31 of each year shown)

Source: Morningstar, as at December 31, 2008

FIG. 1

If you consider the chart above, you will see the performance of the stock market compared to GIC rates for a 25 year period. Although the market has experienced volatility, it still provided a 7.8% annualized return. Closer examination will show us that downturns can rebound to new heights.

## What you have witnessed

### After every "financial-related" crisis there is recovery

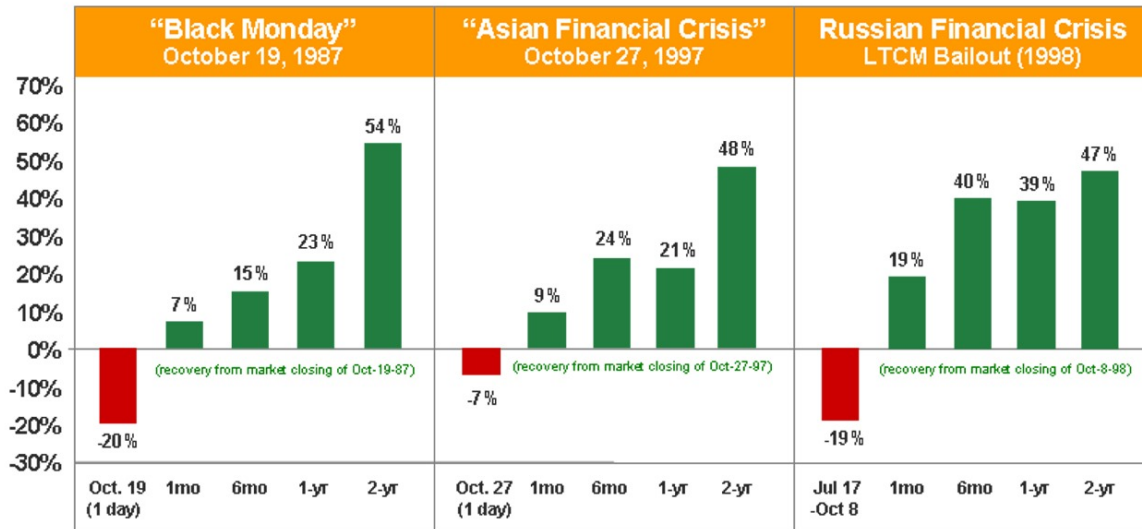


FIG. 2

Source: Standard & Poor's; S&P 500 price index returns; local currency

Down markets present us with opportunities for solid long term returns. The best times to invest over the last 25 years:

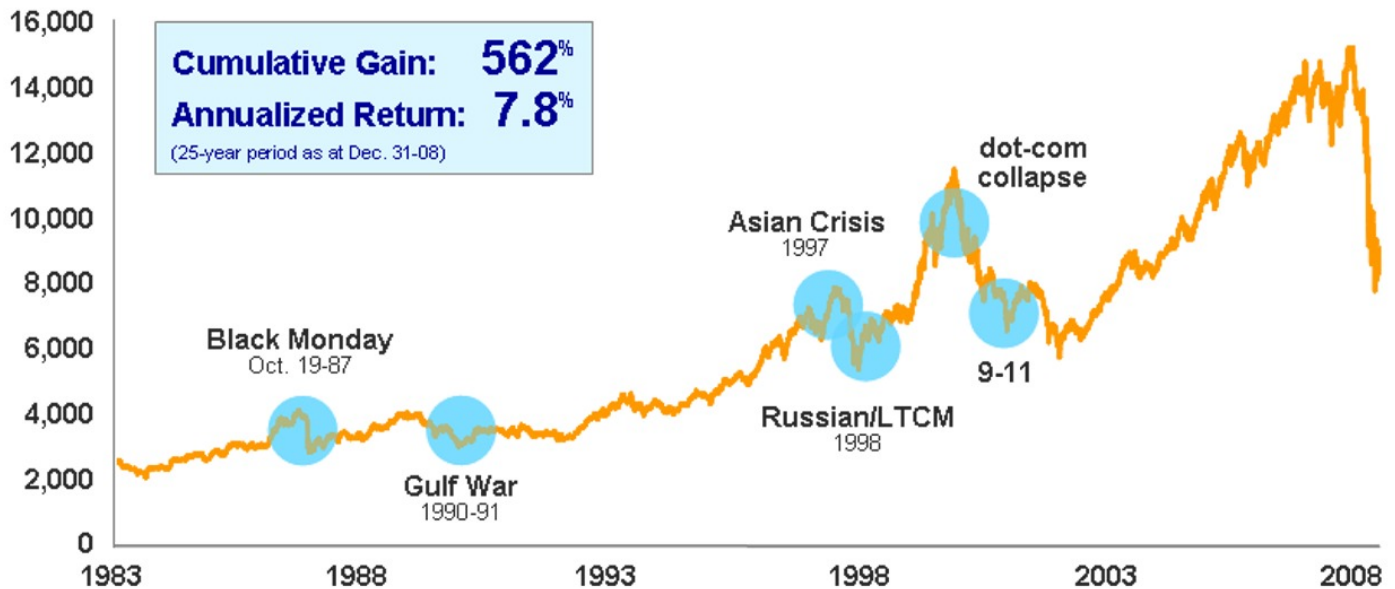
Date	Newspaper Headlines	And...
August 12, 1982	"Death of Equities – Dow Jones closes at year low of 776"	<ul style="list-style-type: none"> <li>o Mortgage rates were at 19%</li> <li>o What were investors doing? (panicking and selling)</li> <li>o One year later, the market was up 34%; two years later the market was up 57%</li> <li>o What should investors have been doing? (buying)</li> <li>o Berkshire Hathaway was trading at \$750</li> </ul>
October 19, 1987 (Black Monday)	"Stocks plunge amid panicky selling; percentage decline far steeper than 1929!"	<ul style="list-style-type: none"> <li>o Dow Jones was down 23.9% in one day</li> <li>o What were investors doing? (selling)</li> <li>o One year later the market was up 23%, two years later the market was up 54%</li> <li>o What should investors have been doing? (buying)</li> <li>o Berkshire Hathaway was trading at \$2600</li> </ul>
1990	"Saddam Hussein Invades Kuwait"	<ul style="list-style-type: none"> <li>o Fear of rising oil prices</li> <li>o What were investors doing? (selling)</li> <li>o What should investors have been doing? (buying)</li> <li>o Berkshire Hathaway was trading at \$5500</li> </ul>
1994	"Mexican Currency Crisis"	<ul style="list-style-type: none"> <li>o Berkshire Hathaway trading at \$15,000</li> </ul>
1998	"Russian Currency Crisis" "Asian Currency Crisis" "Failure of Long Term Capital"	<ul style="list-style-type: none"> <li>o Berkshire Hathaway was trading at \$45,000</li> </ul>
2000	"Nasdaq is down 85% for the year"	<ul style="list-style-type: none"> <li>o Berkshire Hathaway was trading at \$41,000</li> </ul>
2008	"Sub-prime housing bubble, Recession, Financials taking major write-downs"	<ul style="list-style-type: none"> <li>o Berkshire Hathaway is trading at \$139,000</li> <li>o What are investors doing? (selling)</li> <li>o What should investors be doing? Buying great businesses that will weather the storm and still be in business 10, 15 and 50 years from now.</li> </ul>

The following chart shows the same concept in a graph.

## History has demonstrated...

### After every downturn - markets rebounded to new heights

S&P/TSX Composite Index over 25 years (Dec. 31, 1983 - Dec. 31, 2008)



Source: Morningstar, as at December 31, 2008

FIG. 3

What have we learned?

- On average, bull cycles are longer and stronger than bear cycles, and major markets have historically reached new heights in recovery.
- The length of time in the market is what really creates wealth over the long term, not just market timing. Staying invested pays. Bailing out and trying to get back in is costly.
- For building wealth over the long term, the return on equities is still best.
- A Financial Plan is the foundation for successful investing, to help focus on the long term objectives without the emotional rollercoaster.

As we come to grips with the current market downturn and the adjustments to come, comprehensive Financial Planning and a diversified portfolio will help investors ride out the storm. Circumstances may not be favourable for every investor, particularly if you are not investing for the long term, so you should discuss any concerns with your Financial Advisor. When anxiety sets in and emotions start to influence your decisions, it's time to determine if your long term goals have changed, if your time-horizon has changed, or if your risk tolerance in relation to goals and time-horizon has changed. If those things are essentially still the same, then it's important to stick to your Financial Plan to create wealth for your future.

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**Sources:**

*FIG. 1, 2, & 3, "Staying the Course" Presentation, January 2009, Mackenzie Investments  
"Investing in Down Markets", AIC Ltd.*

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