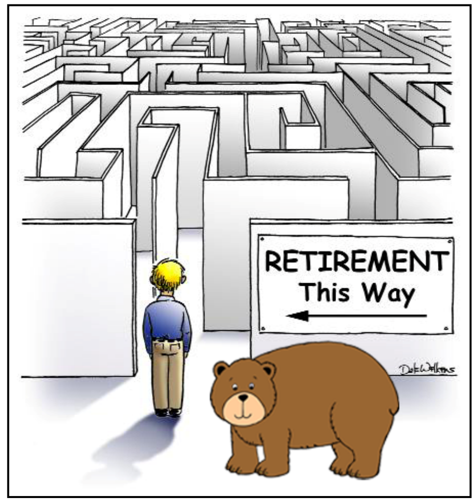
Reprinted from the
Lexington Minuteman

COROMANDEL WEALTH MANAGEMENT

August 2012

Profiting During a Declining Market

Navigating the Retirement Maze



In his book *"Stocks for the Long Run,"* author Jeremy Siegel makes a case for how stock returns always exceed those of bonds over long periods of time. Siegel maintains that during the past 140 years, there has never been a thirty-year period where bonds have beaten stocks. His conclusion: stay invested in the stock market.

But what does the "long run" mean to investors who are nearing or already in retirement? Do they have ten years to wait for the stock market to stage a comeback? Even more relevant today, what does one do if both stocks and bonds are poised to deliver weak returns over the coming decade?

Beware the Bear

Much research has been done on the cyclical nature of stock markets. There are short cycles of three to five years that coincide with economic conditions. Then there are longer cycles, called "secular", which last about 17 years on average. In a secular bull market – think 1982-1999, when the S&P500 was up 15 out of 17 years – everyone is a stock-picking genius. Stocks are where investors want to put their money. The stock market's price-earnings ratio (P/E) rises during bull markets, as investors continually bid up the price (P) that they are willing to pay for each dollar of corporate earnings (E).

In 2000, we entered a "secular bear" market. Nearly twelve years later, the S&P500 is lower even before factoring in inflation, and the P/E ratio is down from over 40 to the high teens. Yet if history is any indicator, we're not done with this "bear." The market doesn't typically turn around until the P/E gets down to single digits, and the average investor has thrown in the towel on stocks. (Recall the August 1979 *BusinessWeek* cover story: "The Death of Equities.") There will be up months and down months, but during a secular bear market the overall trend is decidedly down. Bulls beware.

Ten More Years?

In his recent book *Investing in the Second Lost Decade* (2012), Martin J. Pring makes the case that the current secular bear market could last beyond 2020, and that the ongoing global debt crisis will result in slower growth and deeper recessions. Europe is providing a glimpse of what excessive debt can do to economies and stocks, and they've barely begun to deleverage.

By now, you're probably despondent about the prospects for your portfolio, and wondering what investment alternatives remain, aside from your mattress. The good news is that there are still asset classes that afford some degree of growth potential, inflation protection, and income generation during the remainder of the "bear." However, set your expectations lower than they would be in a bull market, and manage your finances accordingly.

Taming the Bear

Not all stocks are poised to underperform going forward. Grantham, Mayer and Von Otterloo (GMO), a Boston-based investment firm, has a solid record of predicting longer term asset class returns. Their current forecast suggests the following investments:

- High quality US stocks – These would include large-cap "dividend achievers" with a global marketing presence, like those discussed in the June column.
- Emerging market stocks – Strong economic growth, combined with low debt and trade surpluses, will be major drivers for companies in these countries.
- International small and large cap stocks.

In *The Little Book of Bull's Eye Investing* (2012), John Mauldin recommends that investors seek out stocks that represent the best value, as well as those with consistent dividend growth, as both have historically performed better during bear markets.

Another asset class worth considering is companies that own or control hard assets, like real estate and commodities. These will act as a counterbalance to increasing inflation due to excessive currency printing and global economic growth.

Finally, interest rates will eventually have to rise. Thus, keep the durations on your bonds and income funds short for now, say less than five years, or use a laddering approach (see the July column) to reduce interest rate risk. When rates do begin to rise, gradually increase your exposure to income-producing assets.

Bear markets are a normal part of stock market cycles. You can't control them, but you can manage around them. Do that, and you'll be ahead of the pack with your returns.

George Gagliardi is a financial planner with Coromandel Wealth Management in Lexington, where he helps clients develop and implement retirement strategies. He is affiliated with Trust Advisory Group, Ltd., a Registered Investment Advisor, and can be reached at (781) 728-9001 or george@CoromandelWM.com. This article is intended for general information purposes only, and may not be appropriate for your specific circumstances. Investment advice is particular to each individual, and should only be given after an individual situation has been reviewed.