It's Time in the Market, Not Timing

By Mark Palmerino
CCR Wealth Management

Are you feeling pain from the market's performance over the past five years? Your emotions are probably justified considering that the calendar years 2002, 2003, and 2004 all marked the ends of negative five-year rolling return periods for the Standard & Poor's 500 Index. Furthermore, while the S&P 500 was positive again in 2005, the five-year rolling return is barely in positive territory.

However, it should be pointed out that the market's post year-2000 performance could be considered an outlier, rather than the norm. As the table shows, through December 2004, there have been only 10 rolling five-year periods (out of 75) when the S&P 500 posted negative annual returns, according to Ibbotson Associates. While half of these periods occurred during the Great Depression – a time that most of us likely did not experience first hand – the remaining five periods occurred during the global recession/oil crisis of the 1970s and immediately following the market "bubble" in 2000. Fortunately, these are hardly typical events and could be considered some of the most turbulent times in history.

Era	5-Year Period Ended	# of Periods
Great Depression	'31, '32, '33, '34, '41	5
Oil Crisis/Global Recession	'74, '77	2
Post-2000 Market Bubble	'02, '03, '04	3

Furthermore, consider the tragic and negative events of the past five years that have impacted the world's economy and its capital markets. Some events were geopolitical – the September 11 attacks, the conflict in the Middle East, and the widespread threat of global terrorism. Other events were stock market related – corporate malfeasance, Wall Street research conflicts, and mutual fund scandals. While we hope these events are isolated occurrences, the market has continually bounced back and should continue to reward patient, long-term investors.

Sometimes it is important for us to take a step back and look at the "bigger picture. "Times like this may cause us to lose our patience, which is an understandable, but not necessarily a prudent reaction. A common tendency for investors when faced with market downturns, whether prolonged or sudden, is to let their emotions get the best of them. These negative feelings can cause some investors to want to get out of stocks completely. Or, if they stay in the market, there is a tendency to chase the outperforming asset class. Both decisions are often mistakes, as no single area of the market maintains its leadership indefinitely.

Contrast the disappointing last five years in the stock market with the last five years in the real estate market. In the five years ended June 30, 2005 , the nation's median house price grew at an inflation-adjusted average annual rate of 4.9%, according to the National Association of Realtors (NAR), triple the average since the real estate trade group began compiling data in 1968. In locales that are considered "hot" real estate markets, the median home prices shot up 50% or more.

The parallels between the current real estate speculation and the "dot com" stock craze are eerily similar. Just like people who bought Internet stocks with limited earnings prospects on margin,

new mortgage lending practices have led to more highly leveraged home buying. If interest rates climb precipitously, it could leave many of these homeowners, especially those with interest-only or variable rate loans, with far larger monthly mortgage payments than they have now. The danger is not simply that these buyers would lose some of their investment, it's that they could lose their homes. If that happens, it would also add inventory to the market, forcing prices down, thus turning the "boom" into a major "bust."

Despite the current frenzy in the real estate market, history has shown that investors who chase the returns of the investment that is currently in favor – such as shifting from equities to real estate – are often disappointed. Instead, investors should periodically review their individual risk tolerances and time horizons to design a portfolio that can meet the return objectives (or dollar goals) for the amount of risk they are willing – or able – to take.

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