CHANGING GEARS

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"Those who do not study history are doomed to repeat it." This comment by Georges Santayana could not be more relevant today. Times change and so do markets. And after months of research, it is my belief we are somewhere in the early-to-middle stages of a long-term secular bear market. Investing in this type of market is starkly different when contrasted to a long-term secular bull market, which is the type of market familiar to most investors. Allow me to clarify the differentiating factors of these two long-term market cycles.

In a secular *bull* market, stock prices tend to outperform historical averages as a result of various factors, most notably *expanding* P/E multiples (P/E = price-to-earnings) due to price *stability*. The most recent secular bull market began in 1982 and, depending on the source, ended in either 2000 or 2007. Along with price stability, other contributing factors may be lower tax rates and lower interest rates.

In a secular *bear* market, stock prices tend to underperform historical averages as a result of various factors, most notably *contracting* P/E multiples due to price *instability*. The most recent secular bear market began in 1966 and ended in 1982. As the economy goes through a deflationary environment (as we are today) or inflationary environment (what may come in the future), risk premiums increase. Even as earnings from companies rise in the future as the economies of the world improve, it is possible stock price gains will be muted due to contracting P/E multiples.

So what should investors do? When investing in a long-term, secular bull market, one of the best strategies is to own stocks, as much as you are comfortable, and go along for the ride. "The trend is your friend" is a common quote applicable here.

When investing in a long-term, secular bear market, there are three strategies better suited for such an environment: (1) market timing; (2) strategy diversification; and (3) regular portfolio rebalancing. From experience and study, I have yet to come across anyone who has successfully market-timed their investments with long-term success. Therefore, it is not a strategy I subscribe to. However, successful diversification comes from investing your money in investments *designed to behave differently from each other and the markets*. In addition, reviewing your portfolio allocation throughout the year to rebalance your positions can be effective at harvesting gains and reducing volatility. It should be noted, however, that diversification does not ensure a profit or protect against loss and when rebalancing your portfolio there may be tax consequences that should be discussed with your tax advisor.

There are generally profitable opportunities in both types of markets, but only if you adjust your strategy accordingly. It is just like riding a bike – you need to change gears when you travel through the occasional hills and valleys.

For readers who are not current clients, I would be happy to talk with you to review your current portfolio and strategy to identify changes that could be of benefit in this challenging market environment.

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