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The Stock Market Correction

The much-anticipated 10% correction in the stock market has finally arrived. I first started reading about the "inevitable coming 10% correction" last June, when the Dow Jones Industrial Average (DJIA) was bouncing around 8,000. Currently (actually late May) the DJIA has dropped to just below 10,000, so those folks who got out last June have avoided a 25% gain since then.

I went to a conference at the end of May, and one of the speakers gave a presentation entitled "Is the Recovery For Real?" given by Christopher Davis of Davis Advisors. His data shows that the stock market bottoms out roughly four months after the economy bottoms out. We are progressing along that path right now; the stock market bottomed in March of 2009, and the economy began showing some growth in June or July of 2009, right on schedule. Sentiment, or perhaps Fear is a better term, lasts much longer. An example he gave was the cover of *Business Week* from August, 1979 headlined 'The Death of Equities'; the stock market bottom was in December, 1974, almost FIVE YEARS earlier! So, you can expect to hear doom, gloom, and disaster in the news for another few years, at least. The stock market, however, is very likely to resume its upward trajectory based on increasing company earnings, increasing GDP, very low inflation numbers, and slowly improving employment numbers (employment always lags!). When this will happen exactly, no one knows, but it will happen.

Mr. Davis then talks about the experience of the average investor, who is guided by emotions, and tends to be piling in at the tops and pulling out at the bottoms, resulting in 'buying high' and 'selling low', the exact opposite of a successful investing strategy. Over the last 20 years, the average stock fund has returned 8.8% per year, while the average investor in the same funds had an average return of 3.2%. Investor's behavior, buying and selling at the wrong times, account for the 5.6% per year difference. **In dollar terms, beginning with $10,000, the average investor grew their account to $18,775 by buying and selling at the wrong times, whereas if they had just held on for the entire 20 years they would have had $54,023.** The hardest part of my job is keeping people focused on the strategy we designed for them, and not being whipsawed by jumping in and out based on what their emotions are telling them.