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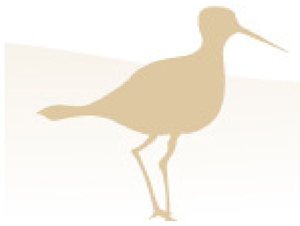
Sandpiper Capital



Gleanings

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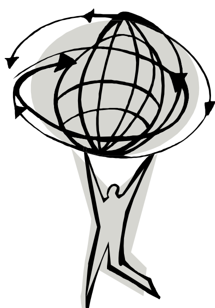
"Why did the actual investor account returns differ so greatly from what you would expect? The answer, as I'm sure that most of you know from experience, is emotion."



The twenty years spanning from 1991 to 2010 saw compound annual returns of 5.9% to 9.1% delivered by the markets, with the lower number coming from the bond market as represented by the ML 1-10 yr Gov't/Corp Index (where the lowest 12 month return was -.5% and the highest was 13%) and the higher number from the S&P 500 index (which ranged from a -43% to a +47%).

According to Dalbar's most recent "Quantitative Analysis of Investor Behavior" that looks at actual investor returns over the last twenty years, the average stock fund investor once again (they've been compiling twenty year investor histories for 17 years and the most recent results are fairly typical) underperformed the S&P, averaging a 3.8% annualized return over the same twenty years. The average bond fund investor also underperformed that index by about 5%, with an annual return that averaged 1.0%.

How do you give up 5%/year over twenty years? Why did the actual investor account returns differ so greatly from what you would expect? The answer, as I'm sure that most of you know from experience, is emotion. The fear that convinces you that selling your stocks when the economic future is uncertain can protect your savings. The hopefulness that persuades you that putting your savings into the stock market when it's booming will bring you a better future. Market after market, time after time, individual investors consistently sell when they should be buying and buy when they should be selling.

In the absence of good information to the contrary (which is usually very hard to come by) investors can easily get caught up by sensationalized daily media reports of economic distress or feel forced to act by seeing a series of monthly brokerage statements where their account values are going down. Those investors who don't open their statements when markets are at extremes, either good or bad, actually do far better than those who read them and feel compelled to "do something".

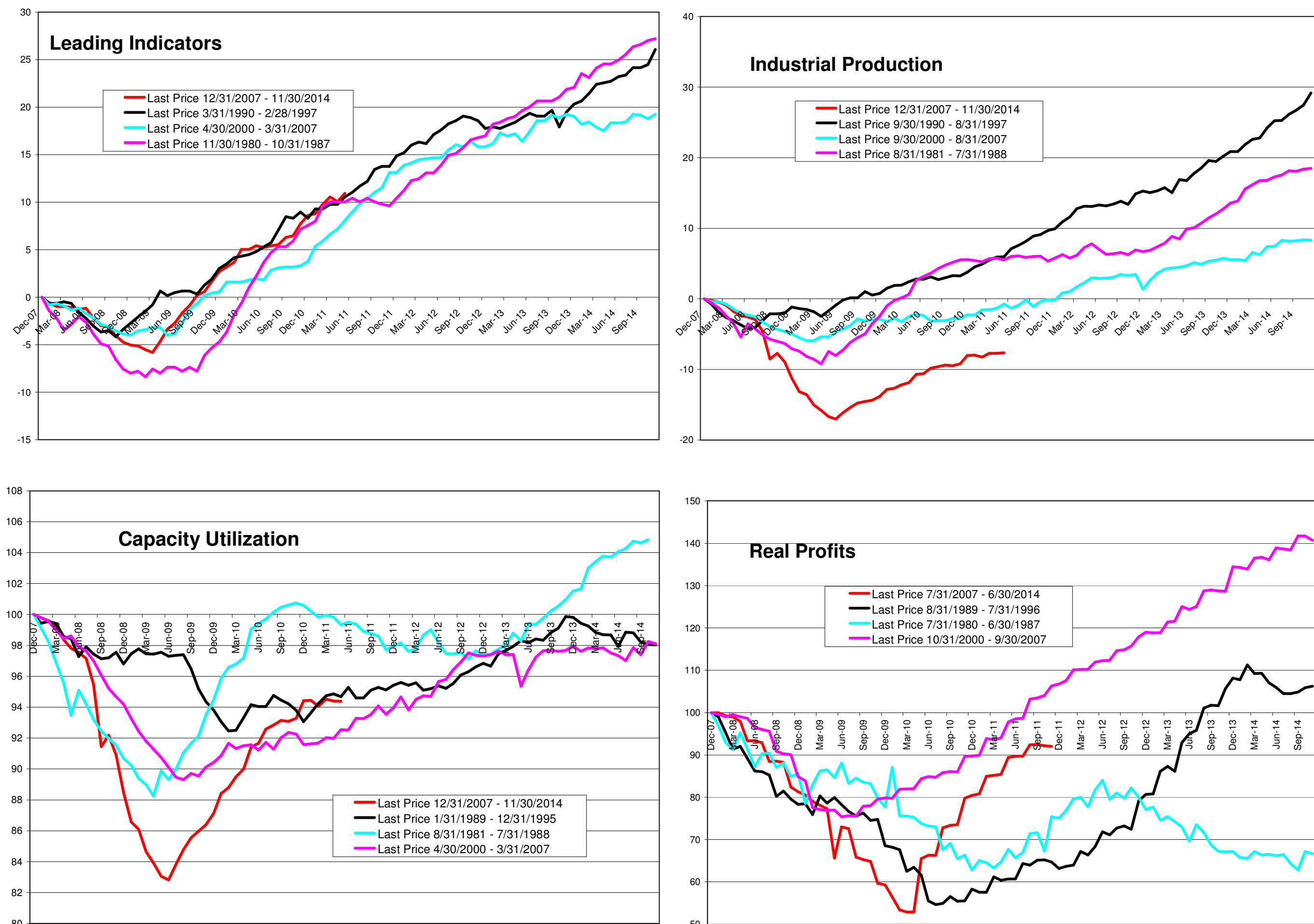
For those with professionally managed accounts, this is certainly easier to do. Hiring a fiduciary to manage your investments gives account holders the confidence to step back from the emotions of the markets and to trust those to whom they've given investment discretion over their accounts. Popular beliefs aside, professional money managers, that is, fiduciaries who manage as opposed to brokers or insurance agents who sell, do consistently capture most of the markets' returns.

Market Returns through 06/30/2011

Index	2008	2009	2010	ytd
S&P 500	-36.9	26.5	15.1%	**6.0%**
ML 1-10 yr Govt/Corp	4.1	5.7	6.0%	**1.8%**
EAFE (Dev. Mkts)	-43.3	31.8	7.8%	**5.0%**
Emerging Markets	-53.2	78.4	19.0%	**.8%**

Recent market weakness has been reflective of another soft patch in the pace of our economic recovery. You'll remember last spring's pull back as leading indicators signaled a similar slowdown, sending ripples of fear of a "double dip" through the markets. While certainly the long term potential rate of growth of the US economy has slowed, looking at the 2008 recession in the light of previous slowdowns leads me to believe that this is a normal flattening in the pace of growth that one would expect given the current headwinds of impaired domestic incomes and an under-capitalized banking sector. The trend is still up even though the rate of growth will be slow.

The series of lines in the charts below indicates the progression of the recovery in domestic markets in each of the last four recessions. I've rebased the start of each at the peak of each indicator immediately before each slowdown. The red lines are the current timeframe extended out as far as the most recent date.



After the snap back in manufacturing since Spring of 2009, we were due for a pause. While slow, the duration of the industrial recovery would normally extend out for at least another year. We should certainly expect a flattish trend for a bit as the substantial recession-induced deferred spending is as recovered as its likely to be, however Leading Economic indicators suggest that we are still on track for growth.

Tom Lukic