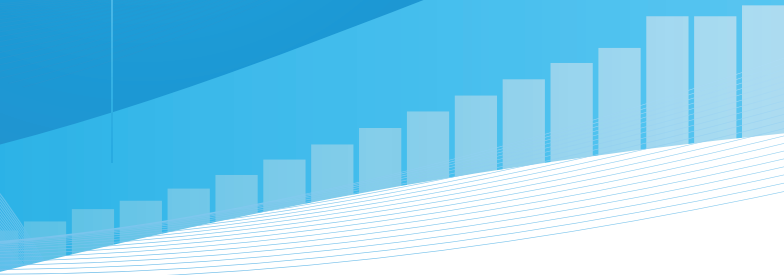


The Hard Lessons of Stock Market History

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The Lessons of Stock Market History

by David Scranton

If you're like most people, you believe there's a great deal of truth in the old adage that history tends to repeat itself more often than not. That's an important adage to keep in mind when it comes to saving and investing for retirement because it allows you to get a glimpse into the future by knowing something about the past. The fact is, the stock market has been repeating itself consistently enough throughout its history to allow us to see in it predictable and repeatable long-term patterns, or market "biorhythms," which are important to recognize and understand when it comes to building a smart, defensive investment strategy.

First, you need to understand something about what particular "version of the truth" Wall Street and most brokers like to tell when talking about the stock market. Most people have probably been told that the market averages about a 9 percent return over the very long run. The way that actually breaks down is that 2 to 3 percent of this return comes from stock dividends, and 6 to 7 percent comes from capital appreciation; in other words a 6 to 7 percent average growth rate over the very long run.

That may sound pretty good, but you have to bear in mind something about how "averages" can be determined, and why they can be misleading. If I told you my business partner and I jogged "an average" of 10 miles per week, you might be impressed until I explained that my partner actually jogs 20 and I don't jog at all. Now, together we do still "average" that 10 miles, so I did tell the truth – it was just a misleading "version of the truth."

That's kind of how that "average" growth rate is determined for the stock market. The way the 6 to 7 percent breaks down over the long run is that there are huge periods of time where the market experiences extreme volatility but the net result is zero growth. Then there are huge periods of time where the market does very well, averaging over 10 percent growth, and often in the 12 to 15 percent range. Factor zero with that high range, and there is your 6 to 7 percent.

Secular Market Cycles

So what exactly are these huge periods of time that alternate between growth and stagnation? They're the predictable, repeatable long-term market cycles I mentioned above. Specifically they consist of one long-term secular bull market (growth) period, and one long-term secular bear (zero-growth) period, which collectively comprise one market biorhythm. Here is the complete history lesson:

From 1899 to about 1921 – based on the most commonly available stock market indicators from that time – the market experienced tons of volatility. Big gains, huge drops, but in the end, all the good and bad years over that long stretch of time washed each other out, resulting in a period of zero growth over 22 years. Right after that came an eight year stretch – from 1921 to 29 – that represented, at that time, the best decade we had ever seen for the stock market. These “Roaring 20s,” as they were known, came to an abrupt halt, of course, with the stock market crash of 1929 and the start of the Great Depression.

But an interesting note ignored by most history books is that “The Crash” actually signaled the start of something very much like that 1899 to 1921 period of zero-growth. From 1929 to 1954 the market again experienced tons of volatility, big gains and huge drops that ultimately washed each other out, resulting in a 25-year stretch of zero growth. Then came another long stretch where the market did incredibly well: 1954 to 1966, the Eisenhower era when America was totally on top of its game. Unemployment was very low and people were making good incomes and living well.

But then in 1966, things started to turn again. Once more we entered a long period, this time almost 17 years, from 1966 to 1982, where the market had major ups and downs that ultimately canceled each other out and resulted in zero growth over all that time. The Dow Jones Industrial Average hit 1,000 in 1966, and in 1982 it was still at 1,000. Then – right on schedule you might say – the market again took off and we enjoyed the best bull market we've ever seen in US history for 18 years. In that time the

Dow went from 1,000 to almost 12,000, a 12-fold increase that culminated with the high flying 90s.

What's even more interesting is that these biorhythms go back even before 1899, to the very beginning of the New York Stock Exchange in 1792. Throughout all of market history, in fact, we've consistently seen extended good times (long-term secular bull markets) followed by extended bad times (long-term secular bear markets) that resulted in zero growth.

Where are We Now?

So getting back to the historical progression of these biorhythms after 1899, where do we stand right now? Well, of course, after enjoying the best bull market in our country's history for 18 years, everything turned again – right on schedule pretty much – in 2000. The century started with another major market drop and in the last 14 years we've experienced tons of volatility and altogether two major drops that have wiped out previous gains.

But let's look closer at these alternating historical cycles and ask ourselves: how long is the average secular bear market, historically speaking, and how long is the average secular bull market? Well, on average these long bear cycles have lasted about 20 years or more, while the bull periods have averaged 10 to 15 years, slightly less. With that mind, how long does it take for the market to go through one full cycle, or one full biorhythm? Obviously, the answer is about 35 years.

In other words, statistically speaking, if you have money that you know for sure you're not going to need or want to spend for 35 years, you should, in theory, be able to put it in the stock market and have it out-perform most other investments. That's because, as we've said, over the very long run the market averages a 9 to 10 percent return. But now you know just what that term "long run" really means, and unfortunately I don't come across too many people in a position to just sit on their nest egg, or even part of it, for three and a half decades.

But what else can the lessons of market history tell us about how we should be saving and investing for retirement in the present? Well, another characteristic of every long-term secular bear market cycle we've been through is that each has included at least three major market drops. As noted, in our current secular bear cycle we've had two so far. What's more, it's common that each sequential drop has been larger than the one previous – and here again our current secular bear cycle has been true to form.

Cyclical vs. Secular

At this point you may be wondering why when you hear a financial analyst on television talking about a “bear market,” he never says anything about it lasting 20 years or more. To most analysts, a “bear market” lasts two or three years at most. Here, again, he's telling you an alternate “version of the truth” based on the textbook definition of a “cyclical” bear market cycle. Remember, one of the key characteristics of a long-term secular bear market is volatility. There are a lot of ups and downs, often lasting several years at a stretch. These ups and downs are the “cyclical” bear and bull markets that occur within the longer-term secular cycle, and they are what TV analysts prefer to focus on when they talk about market conditions.

Why? Well, it's all tied to what Wall Street, itself, does and doesn't want the average investor to know, and its need to speak optimistically as often as possible. It's important to understand that Wall Street knows it can make more money and get more people to invest in their products if people are optimistic and think the markets are going to do well. The reality is that if they talk about short-term cyclical cycles, they can speak optimistically about the markets more often.

Actually, it's not hard to understand why Wall Street, itself, would prefer to talk about short-term cyclical cycles and ignore the very existence of long-term secular cycles. What do you think might have happened to a Wall Street CEO if, in 2000, he had publicly forecast that 20-plus year secular bear market was just starting and advised his sales force against selling any more stocks or mutual funds? He probably would have been out of a job.

So the obvious question now is this: is it possible that this will be the first time in nearly 200 years of history that the stock market will recover after a only 14 years of a secular bear market cycle and without a third major drop? Anything is possible, of course, but the lessons of stock market history clearly tell us that it's far from probable.

Now, how can you start putting the lessons of stock market history to good use today? Simple: by contacting a qualified financial advisor who specializes in the universe of non-stock market alternatives designed to generate income through interest and dividends. This is income you can spend if you're retired, or that you can reinvest in order to grow your portfolio organically, or "the old-fashioned way," with far less worry over damaging losses that could impact your life and sideline your retirement plans.

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