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Understanding the Secular Bear

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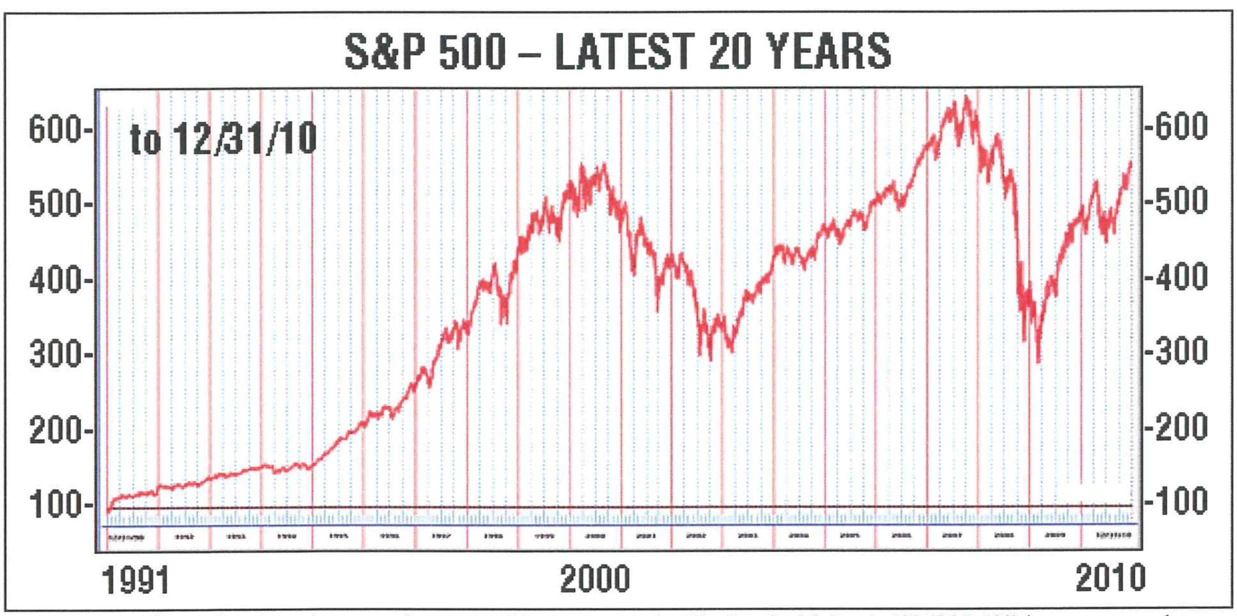
In this letter I want to take a "wide-angle" view of recent economic history, to give you some perspective on possible futures, and to better explain why we favor certain investment strategies to better protect your investments. Let's begin with the difference between "secular" and "cyclical" markets.

The terms "bull market" and "bear market" refer to times when the stock market has an underlying and enduring trend: either up (bull) or down (bear). The terms "cyclical" or "secular" refer to the length of the trends: "cyclical" market trends have typically lasted one to three years (but occasionally as long as four); whereas "secular" market trends have lasted from five years to as long as twenty-five years.[1] To graphically see the difference, please refer to the chart below which shows the history of the S&P 500 with dividends reinvested over a 20-year period of time from January 1, 1991 to December 31, 2010.

With the wisdom of hindsight, both Secular and Cyclical trends are obvious in this chart.[2] From 1990 to 2000, there is a clear Secular Bull Market marked by a consistently rising trend, and every set-back is both relatively shallow and brief. The time period from 2000 through 2010 shows two Cyclical Bull phases and two Cyclical Bear phases within a Secular Bear Market. You can clearly see that any investor who invested in January 2000 did not have any appreciable gain after 11 years because all the cyclical changes took place within a Secular Bear.



The hypothetical illustration above does not reflect any real investment results. The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general. Investors cannot directly invest in an index.

Right now two important -- and mutually exclusive -- investment questions confront us:

1. "How long will we remain in a Secular Bear market?" or,
2. "Is the Cyclical Bull market, which began in April 2009 actually the beginning of a new Secular Bull market?"

These questions are important because investment strategies that work very well in bull markets (like "buy and hold," or "buy on dips," or "strategic asset allocation") can lead to unrecoverable losses in Secular Bear markets. Unfortunately, there is no way to know the answers to these questions in advance. A study of market history, from 1896 to the present, shows that Secular market trends have lasted as long as 25-years (!) and as short as 5-years.[3] We are 11 years into a Secular Bear market at the close of 2010.

In my judgment, it is only prudent to assume that the Secular Bear market has more years to run.[4] It may be a number of years before the crash in Real Estate and high unemployment can recover, there are record deficits in the major developed countries throughout the world, and painful political decisions may or may not be made in time to forestall even more financial pain. Therefore, I am going to assume that this bull market is only cyclical and we will manage our investment strategies accordingly. This means our asset allocations will be tactical and not "buy and hold;" we will attempt to have stop loss systems in place for every asset class that we use; we will employ outside managers like Ocean Park that have a long history of avoiding significant losses; and we will recommend insurance guarantees to cover significant assets that you use for lifetime income.*

If successful, our strategies will reduce losses in the next cyclical bear market while participating in some of the gains of the cyclical bull market. If I am wrong, and the Secular Bull market has begun, your accounts should continue to grow, but not as much as they would have without our safety measures. Any tactical asset allocation sometimes avoids volatile assets that achieve better results. Any stop-loss system sometimes stays too conservative and loses out on some potential gains. Insurance guarantees cost us premiums even if we never suffer the losses they are meant to protect. However, if I am right, patience, caution and nimble allocation strategies will prove their worth. Please call us if you have any questions about this brief overview of our strategies. We are happy to help you with any of your financial concerns.

*Guarantees are based on the claims paying ability of the insurer.

[1] Rydex-SCI, "Dow Jones Historical Trends," publication number DJCSI-15-0111 x1211 #2157.
[2] Chart courtesy of Ocean Park Asset Management.
[3] Rydex-Sci, ***Op.Cit.***
[4] Ed Easter.ing, ***Probable Outcomes***, 2011, makes an interesting case for the continuing Secular Bear.