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TRANSITIONS

CORRECTION OR BEAR MARKET?

Are we in a *correction* or have we entered a *bear market*? One answer is in the financial text books that define a decline off the highs of 10% as a correction, and a 20% decline as a bear market. Such clear-cut definitions make news reporting easy.

Yet, these definitions are wrong. My gut instincts have always felt the next correction would be greater in decline, mainly because we have not had a true corrective process in 9 years. Thus this decline is measured from a point in time where the market ran nearly straight upwards for many years. After such a multiyear run up, a real "correction" could easily decline 15% to 20% in value. A "bear market" would not only be a larger decline, but would occur when market conditions are such that there no longer is any reason to want to own stocks. Things that occur in a bear market are a weakening economy, high unemployment, with individuals having almost no disposable income.

A real correction needs both *price* declines and *time* for the market to digest its gains. Time is not measured by a short interval of a day or two, but rather several weeks, or even several months. As opposed to the brief prior price declines, we now are seeing price declines with the passage of time. Corrections are a normal activity in the markets, where stocks move from weaker hands to stronger hands.

A wrinkle in these markets is that many large market participants seem to completely rely on their computer models for investing. With all these computers in charge of the selling, the old herd process is alive and well, where everyone decides to sell at the same time. At such times, the buyers wisely step aside, and we see this greater

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volatility. Without any human interpretation or judgement based on knowledge of markets, the selling will continue until it is finished.

These market conditions are not terrible, they simply have been missing for a decade. Stocks are being sold without regard to value, or future growth prospects. Opportunities are being uncovered, but prices may go lower as part of the corrective process. What should we do? Unlike many Wall Street products like ETF's and mutual funds that must remain fully invested in stocks, an individual portfolio should be invested differently. Not only do we hold bonds and money market cash in client accounts that are not correlated to stock markets, we have been emphasizing an income component in stock selections, instead of a total reliance on capital appreciation for return. This type of portfolio construction enables our client portfolios to weather these market conditions and take advantage of opportunities.

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When reviewing portfolios during these times, I fundamentally look at the stocks you own. We are invested in good industry sectors. Businesses are generally strong, solid companies. And their dividends are secure. What has changed is simply the prices. Prices are lower largely due to the market correction, as opposed to a material change in the business of the underlying companies. This change in price becomes a problem if you need an amount of cash that requires the substantial sale of stocks. Otherwise, since we hold good stocks, these changes in price are more an annoyance than an impact to your financial health. We patiently await for the prices to stabilize...all while collecting interest and dividend income as your return.

Visit our Resource Center for more market commentary and insights.

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