

# INVESTMENT UPDATE

THE MUNCY BANK  
& TRUST COMPANY

---

**INSIDE THIS ISSUE:**

---

*Whenever the markets are down sharply for 10 years a good decade follows.* **2**

*Investors sell their mutual funds too quickly.* **3**

*The affluent feel better, consumers are coping with the financial crisis, and more.* **3**

*Active mutual fund managers can't seem to beat the indexes.* **4**

---

**Points of interest:**

- Investors have experienced stock, housing, and commodity bubbles during the last 15 years.
- The justifications for bubbles sound good at the time, but fail in retrospect.
- The next boom will probably be based on another “new paradigm.”
- Watch for stories about inflation, gold, and emerging economies.

## IT IS TIME TO LEARN HOW TO AVOID SPECULATIVE INVESTMENT BUBBLES

**W**e have just come through three big speculative investment bubbles: the great stock market bull of the 1990s, the speculative run-up of housing prices that ended over a year ago, and the China-driven commodities boom that ended last fall.

Each were followed by painful crashes and price readjustments that damaged many investors' wealth. Indeed, we are still working through the pain of the housing collapse and stock market decline.

Speculative bubbles have occurred in markets for hundreds of years, and yet investors never seem to heed the lessons of the last bubble before getting sucked into the next one.

**Stocks to houses**

U.S. investors moved too quickly from stock mania to housing mania in the early part of this decade.

A nearly 10-year boom in stocks through early 2000 occurred on enthusiasm over globalization of the economy, the growth of high technology industries, falling inflation, and increased productivity due to the Internet.

Never mind that falling inflation had never been a reason for expanding stock markets in the past (indeed, during the 1960s boom inflation rose rapidly).

Also, the Internet had not been dominant enough in the 1990s to enhance productiv-



Investment bubbles boost a market past the point of common sense, usually on the basis of a “story” that later proves to be nonsense.

ity. Many high tech companies, especially the dotcoms, never fulfilled their promise.

When the crash came in 2000 and extended over the next two years some investors decided that housing was a safer, surer long term bet.

They were prompted by the availability of cheap borrowed money after the Federal Reserve cut rates in the wake of the bear market in stocks and a recession.

The boom was also prompted by the belief that second homes in scenic areas would become more popular as Baby Boomers could work remotely from their homes or

would want to retire to scenic shorelines and mountain tops.

**Disappointed again**

The outcome has been disastrous as home prices have plummeted by record amounts in the most popular areas and aren't expected to begin rising again for years.

The third boom occurred in commodities, dragging the stock markets up with it, on the conviction that newly emerging economies like China and India would suck up a vast amount of natural resources, pushing up prices of oil, metals, grain, and other

*(Continued on page 2)*

## LOOK FOR ‘NEW PARADIGM’ STORIES THAT WILL PRODUCE MORE BUBBLES

(Continued from page 1)

physical goods. That bubble crashed into a wall last fall in the midst of the credit crisis and oil plunged from \$140 a barrel to as low as \$40 in less than six months.

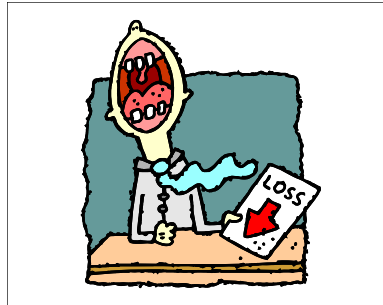
### The next boom

So how will we recognize the next boom? One way is to look for stories that sound good, promising new paradigms that will break with historic patterns of price relationships.

Here are some current

“stories” that might qualify:

- Inflation will skyrocket due to increase government borrowing and investors will flee to the safety of gold.
- The dollar will fall and the U.S. economy will decline. Foreign governments will sell our bonds, sending interest rates soaring.
- China, India, Russia,



New paradigms usually disappoint.

and Brazil will continue their rapid growth independent of trends in the United States.

## BAD MARKET DECADES FOLLOWED BY BULLS

The last 10 years have been a miserable time to invest in U.S. stocks. Mutual fund manager JennisonDryden estimates that U.S. stocks (as measured by the Standard & Poor’s 500 Index) lost 3 percent per year on average from April 1999 through March 2009.

That’s a far cry from the average annual return of 9 percent from 1929 to the present.

JennisonDryden studied all 10-year monthly rolling periods from October 1929 to the present to see how U.S. stocks did during the subsequent 10-years after each bad 10-year period.

### Bad times are common

It found that it is not uncommon to have moderate to poor returns for as long as 10 years. Out of 715 rolling 10-year spans, it found 91 periods when average annual returns were 5 percent or less.

JennisonDryden dubbed those “muted return markets.”

The good news for investors who survive those low-return periods comes over the subsequent 10 years, when the market rises by an average annual return of 15 percent, the study found.

The worst 10-year recovery period, which started in October 1939 at the end of

the Great Depression, saw annualized returns of 8 percent a year, far better than the average annual loss of 3 percent per year in the 10 years from the Crash of 1929 through 1939.

Although 8 percent a year may not seem like a spectacular return, it would more than double an investor’s principal.

Another 10-year period of

muted returns saw stocks rise by only 4 percent a year from June 1964 through May 1974, a period of rising unemployment, an oil shortage, and rising inflation following the Vietnam War.

### A nice recovery

But the subsequent 10-year period saw stocks increase

by an average of 11 percent per year.

One of the best recoveries came after the period from August 1972 through July 1982. That muted period saw returns of only 5 percent a year, but the following 10 years through

July 1992 produced U.S. stock returns of 19 percent per year on average.

While future returns are never guaranteed, investors who suffered through the last 10 years have cause for optimism about the future.



Every time the U.S. stock market has had a bad 10-year period it has delivered much better returns over the next 10 years.

*“The good news for investors who survive those low-return periods comes over the subsequent 10 years.”*

## INVESTORS WHO GROW IMPATIENT SHOOT THEMSELVES IN THE FOOT

American investors, both professional and amateur, have become a cranky lot with little loyalty to the stocks and mutual funds they buy.

Back in the 1960s, the average holding period for a stock on the New York Stock Exchange was eight years. Today the average is just nine months.

Mutual fund investors used to hang onto their funds for as long as 16 years on average in the 1950s; now they hold only for an average of four years. Investment researchers say this hyperactivity hurts the average investor's returns.

### Higher turnover

Some researchers speculate that the big increase in availability of information about stocks has made investors more active in recent years.

Behavioral researchers have shown in studies that more information increases an investor's confidence, leading to more decisions to buy and sell.

The ubiquity of published short-term performance figures may also influence investors. Seeing the results of your investment compared to others on a quarterly, monthly, and even daily basis may encourage more frequent trading.

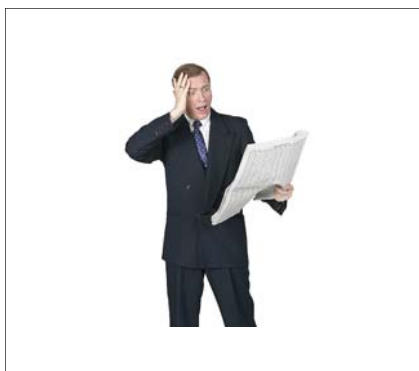
### Fund traders lose

Those who hang onto their mutual funds for only a few years are likely to suffer subpar performance, found a study by The Brandes Institute in 2006.

Investors are likely to sell when their mutual funds go through relatively short periods of underperformance relative to competing funds.

The Brandes study found that the funds with the best 10-year performance records can have severe *underperformance* for up to three years.

Its analysis of the top 10 percent of domestic funds over 10 years found they beat the Standard & Poor's 500



Investors hate to see their stocks or funds fall out of favor for a short time.

Index by an average of 3 percent per year.

However, some of those funds had single-year performances of as much as 37 percent *below* the S&P 500. The worst three-year returns for the funds ranged from 1.2 percent to 20.4 percent below the index. Similar results were found when studying international stock funds.

Investors who gave up on their funds during those periods of underperformance missed out on stellar 10-year returns.

*“Investors are likely to sell when their mutual funds go through relatively short periods of underperformance relative to competing funds.”*

## LESS WORRY, COPING WITH CRISIS, & MORE

Affluent individuals are less worried about the economy than they were in 2008, a new survey shows.

The reduction in concern may be a plus for the economy, said Bob Shullman, whose firm, Ipsos Mendelshohn, conducted the survey.

The percentage of households with \$100,000 or more in annual income who worried about the economy declined in April to 46 percent from 60 percent in December.

Concerns about health

care and unemployment also declined, Ipsos said.

### Coping with crisis

Consumers are finding ways to cope with the recession and bear market that don't involve delaying their retirement dates, says the McKinsey Consumer Retirement Survey.

Instead, they are cutting spending and paying down debt, the survey found. Also, more potential retirees are planning to leave smaller estates to their heirs as a way of boosting their own retirement incomes.



The majority say they have not changed their employer retirement plans in response to the crisis.

### IRAs and 401ks shrink

Retirement assets plummeted in 2008, dropping by 22 percent during the year, reported the Investment Company Institute, the trade association for mutual funds.

Assets held in individual IRAs and employer-provided pension plans and savings plans declined to \$14 trillion by the end of the year from \$17.9 trillion at the end of 2007, the Institute said.

Investment Update is published monthly by OBS Financial Services, Inc. © 2009 All rights reserved. Information has been obtained from sources believed to be reliable, but its accuracy and completeness, and the opinions based thereon, are not guaranteed and no responsibility is assumed for errors and omissions. Nothing in this publication should be deemed as individual investment advice. Consult your personal financial adviser and investment prospectus before making an investment decision. Any performance data published herein are not predictive of future performance. Investors should always be aware that past performance has not been shown to predict the future. If in doubt about the tax or legal consequences of an investment decision it is best to consult a qualified expert. OBS Financial Services, Inc. is a Registered Investment Advisor.

---

## ACTIVE MUTUAL FUND MANAGERS CAN'T SEEM TO BEAT THE INDEXES

Active mutual fund managers may tell you their expense is justified by market-beating results, but the data contradicts them, says Standard & Poor's.

S&P does a regular study of mutual fund performance vs. passive indexes and regularly finds that most active fund managers can't beat their respective indexes.

The latest study shows that over the five years from 2004 through 2008 two-thirds of domestic stock funds lagged behind the indexes. The results are similar to those obtained during a study of the previous five years, 1999 through 2003.

Among individual fund categories, large cap value funds had the best record, with only 53 percent losing out to the S&P 500 Value



Mutual fund managers often fail when trying to ride the market to higher returns.

Index, while small cap growth funds had the worst relative performance as 96 percent of funds were beaten by the S&P SmallCap 600 Growth Index.

The recent bear market gave S&P another chance to examine the common wisdom that active managers can do better than the indexes in a bear market.

"One of the most enduring investment myths is the

belief that active management has a distinct advantage in bear markets due to the ability to shift rapidly into cash or defensive securities," S&P said.

The majority of active mutual fund managers failed to beat their respective indexes during 2008, just as they did in the 2000 to 2002 downturn.

The exceptions once again were managers of large value stock funds,

S&P said.

It wasn't just domestic stock funds that failed to beat the indexes—S&P found similar average underperformance among managers of international stock funds and fixed income funds.

Over five years municipal bond managers lagged by 2 percent behind the indexes, while corporate bond managers fell 1 percent behind.