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LEARNING FROM THE PAST

Stocks are up! Bonds are down! Stocks are down! Gold is up! Oil is down! Bonds are up! Interest rates are…down – but expected to go up! What's an investor to do? There are a tremendous number of distractions for our attention today but for those investors who can see the big picture it might serve them well with their investment decisions.

For this month's article let's look at 100+ years of data as presented by Crestmont Research (www.CrestmontResearch.com). There is a wealth of information that has been compiled in the chart below, so let's dig in. Unless you have a large magnifying glass I suggest you print this article and use the following link to view the chart in full on your computer screen (http://crestmontresearch.com/pdfs/Stock%20Secular%20Chart.pdf).

In order to see the forest through the trees and keep this relatively simple, let's draw our attention to only three main concepts, which are; **bull and bear market cycles**, **the ratio of positive to negative years within each cycle**, and **the beginning and ending P/E ratios (**P/E = price-to-earnings**)**.

With regard to **bull and bear market cycles**, you will notice in the top left corner of the chart the various cycles that have occurred. For 20 years from 1901-1920 the stock market provided flat returns (yes – 20 years)! From 1942-1965 the stock market provided excellent returns for 24 years. Then terrible returns for 16 years from 1966-1981. And for 18 years the stock market provided tremendous returns from 1982-1999. Do you notice how the bear (down) cycles last about as long as the bull (up) cycles? If this pattern repeats we may have a while to go before this bear market cycle ends.

With regard to **the ratio of positive to negative years within each cycle**, they can most clearly be seen by looking at the red and green boxes. *During bear market cycles the annual returns were more often negative on average than positive.* In addition, the losses in the negative years were typically far worse than the gains in the positive years. During bear market cycles it's the losses we need to be very careful to avoid when they occur.

With regard to **beginning and ending P/E ratios** direct your attention to the line item called P/E Ratio. This ratio tends to increase during bull cycles and decline during bear cycles. For instance, during the bear market cycle of 1901-1920 the P/E ratio began at 23 and by the end was at 5! During the bull market of 1942-1965 the P/E ratio began at 9 and ended at 23! Considering the current bull cycle began at 42 and at present is at 21, where do you suppose it will be at the end?

Remember, as Dow Theory oracle Richard Russell says time and time again, "**you make your money in the buying**." If you buy anything at the right price you will likely make a profit. Buy at the wrong price and losses are likely in your future.

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