

Advisers weathering bear market so far

Many have yet to react to a terrible decade for stocks

By **Dan Jamieson**

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Although this decade could turn out to be the worst such period for stocks in modern history, advisers don't yet seem to be feeling the full effect.

Some bearish observers think too many advisers are blissfully unaware of the dangers of the secular-bear-market period they believe is upon us. These periods are 15- to 20-year phases marked by volatile sideways action in which stocks generally make little headway.

One reason for the continued optimism is that many advisers' asset allocation plans have worked well enough to avoid severe pain — at least so far.

Client portfolios run by advisers typically are diversified with smaller-capitalization and value stocks, foreign equities and bonds — all of which came through the 2000-2002 period in OK shape, and they performed exceptionally well from 2003 until last fall. "If you owned some real estate, commodities and small stocks, they did fairly well," said Louis Stanasolovich, president of Pittsburgh based Legend Financial Advisors Inc., which manages about \$360 million.

Clients are surprisingly sanguine as well.

The experience from 2000 to 2002 taught clients that "the markets [can] come back from a really hard time," said Chad Coe, president of Coe Financial Group Inc. in Deerfield, Ill., who runs \$100 million.

However, recent market activity has reminded advisers that the bear market might not be over.

Some market historians who worry about a long bear market period said that advisers have yet to react in a meaningful way.

Most advisers and investors don't realize that the market has entered a bear market phase dominated by commodities inflation, Mr. Stanasolovich said. "Some advisers are looking at [investment options other than stocks], but most aren't," he said.

That more advisers have yet to make a shift away from heavy stock exposure is "shocking," Mr. Stanasolovich said.

That inaction is especially surprising given that this decade is on track to be one of the worst for stocks in a lifetime.

The Standard & Poor's 500 stock index will have to gain 41% in the next 18 months just to end with a total return equal to inflation, said Ron Surz, president and chief executive of PPCA Inc., a San Clemente, Calif., industry consultancy.

Even the decade of the 1930s produced about a 2% real return thanks to 2% deflation.

[Unfortunately, many investors and advisers "have no clue" what can happen in secular-bear-market periods, said Robert Kargenian, president of TABR Capital Management LLC, an Orange, Calif., firm that manages about \\$160 million.](#)

Some bearish observers have warned that the market is unlikely to make a long-term bottom anytime soon.

Most indexes have fallen more than 20% since the highs reached last October.

["A normal bear market is \[a drop of\] 30%," Mr. Kargenian said, who nevertheless feels that the market may have reached an intermediate-term bottom.](#)

There typically are three to five shorter cyclical bull and bear markets within a longer-term secular bear market, Mr. Stanasolovich said.

"We're probably now somewhere in the middle" of a second cyclical bear market within a secular bear period, he said. The secular bear market probably has another seven to 12 years to go, Mr. Stanasolovich added.

Even with low inflation, stock market returns will be limited to the low to middle single digits for another decade, said Ed Easterling, president of Crestmont Holdings LLC, a Dallas-based investment firm that researches market cycles.

Not everyone is so bearish, of course.

"Businesses [in the S&P 500] today are selling cheap," said Steve Booren, principal with Capital Consulting Inc. in Greenwood Village, Colo. The earnings yield on the S&P 500 plus its dividend are paying investors more than 8% — double the 10-year Treasury bond, he said.

If the index simply reverts to its long-term mean after the bull market run last decade, "there may be a heck of a run from here," Mr. Booren said.

MAKING THE SWITCH

Believers in the bear market say that active management is the way to go, in contrast to indexing, which works best in sustained bull markets. Bill Barack, president of Barack Capital Management LLC of Bay Village, Ohio, has a slide presentation he gives to investors, warning them that it takes several years for people to adjust their thinking from what worked in the past — a buy-and-hold period — to the period now, where they need to be more active.

His clients' portfolios are heavily in cash as well as foreign-currency ETFs.

Mr. Stanasolovich also uses foreign currencies, plus hedging strategies, managed futures, real estate and "all types of commodities plays."

This diversified mix makes portfolios "work better" than pure stock and bond portfolios, he said.

"Most people are not diversified enough," Mr. Stanasolovich said "With commodities [and other] alternatives, you stabilize your portfolio," which allows investors to withdraw income.

The silver lining in this bear market is that advisers have many more options for diversifying portfolios.

Advisers "are smarter about building portfolios and as result will gain clients if they don't lose too much money," Mr. Stanasolovich said.

"In this environment, advisers have become more sophisticated," Mr. Easterling said, "and the quality of an adviser can make a significant difference."

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