Boys Arnold & Company
WEALTH MANAGEMENT

Investment Perspective

As one of the more tumultuous quarters in recent memory draws to a close, investors are left to ponder whether or not the worst is over. Recall in August we wondered in an email if the S&P 500 had bottomed on August 8th after a horrific 6.7% sell-off, closing at 1119.46. That the market has held that level, briefly testing it on a couple of occasions only to bounce higher each time is encouraging. Is this the all-clear signal? It is impossible to tell, but interestingly market corrections do not usually end with the proverbial "wash-out" sell-off. Rather, the bottom is often marked unceremoniously and subtly, as slowly improving days feed on themselves and the market grinds steadily upward. The capitulation sell-off, as it were, usually occurs days if not weeks before an actual bottom.

What we do know with certainty is that selling into weakness with the expectation of timing the reentry is unrealistic, and such attempts can be extremely damaging. In its recent *Market Update*, Fidelity Research noted that over the past 30 years, missing just the best five days of the market reduced one's average annual return from 8% to 6.5%. Missing the best 20 days, or just one month of trading, reduced the return to 3.7%! This differential, compounded over 10 or 20 years, would have devastating consequences on a portfolio.

While the risks and uncertainties plaguing markets this summer seem uniquely daunting, astute investors have noted that this summer is shaping up a lot like last summer, when, you guessed it, troubles brewing in Europe and concerns over slowing global economic growth caused a 16% correction, roughly equivalent to this year's drop of 18% from the peak in April through August 8th. Last year, the concerns faded on hopes that the EU would get its act together, the Fed came to the rescue with Quantitative Easing Part 2, and the correction gave way in August to a robust year end rally. To most, the infamous "flash crash" seems a distant memory. The point is simply that in the middle of market downdrafts, as fear reaches its apex, it is human nature to feel that things are worse this time, inadvertently preventing one from seeing beyond the current turmoil and obscuring positive signs when they appear. This is evident by the current extremely bearish sentiment readings and a withdrawal rate from equity mutual funds not seen since March 2009.

Believe it or not, the economy is still growing, although the risk of a recession has undoubtedly increased. Housing and employment data remain dismal, and despite record profits, companies are beginning to send signals that they expect much slower growth ahead. Best Buy, the largest consumer electronics retailer, recently announced it would hire half as many temporary workers this year for the holiday season as it did last year. The moribund economic news, coupled with an increasingly acrimonious political environment, does not inspire confidence that things will improve. However, while it cannot be ruled out, a recession still does not seem likely, and the indicators we watch suggest that for the most part the financial stress in Europe is presently contained. Indeed, despite the problems in Europe and slowing growth in China, the global economy is still expected to grow approximately 4% in 2012.

Working our way out of the problems caused by decades of easy credit and excessive leverage will be a long, hard slog. We should expect below average economic growth, and until we get further along in this healing process, markets will remain hypersensitive and vulnerable to real and perceived crises. The key question, it seems, is what have markets already discounted? No one knows for sure, but those with a balanced portfolio of quality holdings who maintain a long-term investment perspective will be best positioned to weather the storm and achieve their goals.

October 2011