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6 things 2013 should have taught us, but didn't

Market Watch

BY THOMAS BRUECKNER

As we reflect on another year in the financial markets, whether you were deeply invested in equities or safely earning market-linked interest as they rose, it is once again enlightening to see who was right — and who was way off — in 2013. And what investors should have learned but probably didn't.

Here goes:

• The forecasters were wrong, again. At the end of 2012, CNNMoney polled 30 of the major asset managers on Wall Street, asking them where they thought the S&P 500 was likely to finish the year. Consensus answer: 1490, or a gain of about 4.5 percent over 2012. At the end of the year, the index stood at 1848, a gain of 26 percent, due primarily to the Fed's $85 billion in monthly asset purchases from February through year end.

• You have a long way to go (to make up for the last 14 years). The great investor Sir John Templeton wisely said, "Bull markets are born on pessimism, grown on skepticism, mature on optimism and die in euphoria. … The time of maximum optimism is the best time to sell."

At this stage, any honest investor would have to conclude that we are somewhere between optimism and euphoria, and that the time for profit-taking may be nigh at hand. Still, have the markets really done that well lately? Actually, no — and here's the astounding truth of it: Since the start of the new millennium, the S&P 500 is up just under 26 percent in 14 years, or a paltry 1.85 percent annual yield.

• Don't fight the Fed (when it's being accommodative). It's become obvious to even the most devoted market watcher that it's not your father's stock market anymore. Our beloved Federal Reserve has created credit junkies, addicts who are forever convinced that any slowdown in the economy, and corresponding sell-off on Wall Street, will be bailed out by a Fed whose sole mission is to keep investors happy. In the end, it doesn't matter why the market's going up; it only matters that it is.

It's buyer beware, as the bull market turns 5

• The Embellishment Crowd is alive and well. To this day, the companies that produce the graphs that brokerage firms use to illustrate market history are highly deceiving.

Take a look at an honest chart of the last 14 years, and you'll see a market trajectory worthy of the paltry 1.85 percent annual growth we've had: low and shallow. Look at the charts published by the embellishers and you'll see one that a) assumes reinvested dividends every year, year after year (as if no one ever retires and begins living off them), b) zero fees paid, ever, and c) no impact from taxes or inflation. Naturally, such a chart makes the twin declines (-51 percent and -57 percent) of the last decade look like miniature potholes on the sharply ascending highway to perpetual profitability. Conclusion: There's never a bad time to buy.

• Stock price manipulation still works. In reading numerous analyses of the market's performance this past year, it's obvious that many firms have been putting lipstick on the proverbial pig that is their accounting department.

Much of the "profits" we've seen have come not from selling more product, but from downsizing, layoffs, outsourcing, embracing automation and technology, moving certain employees to part-time, and even the hiring of temporary workers. Some firms also issued bonds, then used those funds to buy back their own stock, driving their share prices higher, thus attracting new buyers. Moral: If the sales aren't there, just reshuffle expenses to make yourself look more profitable; the result is the same.

• Some of the gains, in exchange for none of the losses, works even better. Index strategies that credit market-linked interest when markets are up, retaining those gains when they decline, have benefitted clients far better than full-risk exposure these past 14 years. Our clients are touting average yields of 6 and 7 percent and higher, during a period in which the S&P 500 has barely averaged 1.85 percent, all while sleeping very well at night.

Markets could certainly go higher still, but the average duration of bull markets is 3.7 years. Currently we are at 4.9 years and slowing. Buyer beware. NHBR

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