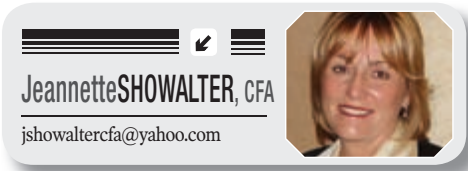


# MONEY & INVESTING

## Love is in the air



It seems that people are once again smitten by the U.S. equity market. Words such as; "I love this stock" or "I love the market at these levels" are being bantered about again.

But, as many a woman has heard her mother say, "Be careful. Just because you love someone, it does not mean he loves you. Look at his actions more than words. It will speak volumes."

So you love the market, but does it love you? Is it a passing moment of passion or is the market really going to be there for you — for your retirement, for your children's college funds, for your medical needs? Are you assuming reciprocal treatment by the market? Well, let's look at how the market has treated you. Maybe it, too, will speak volumes.

Assuming this is long-term relationship, let's look at the past 10 years.

Total return includes capital gain and dividend income. For the 10-year period ending Oct. 23, the Dow Jones Industrial Index had a capital loss of 5 percent.

CDs earning 3 percent per annum or cash values in a whole life insurance policy earning a statutory rate of 4 percent per annum, did far better than the Dow. However, dividend income offset the 10-year loss. Total return for the index

for the entirety of the 10 year period gained 19 percent.

Those truly "in-love with equities" argue that long term is not 10 years; long term is 20, 30, 40 years or more.

OK, so let's look at a much longer period of time and see if this relationship was reliable or more like a drama queen? Translated: how much did the U.S. equity return vary from the average (actually the average annual compounded rate of return.)

Equity investors are told to expect 8 percent to 9 percent from U.S. equities over the long term. Unfortunately people hear this and they actually expect 8-9 percent each year. If you were invested in 1985-1999, you are accustomed to consistent and large gains and expect much more than 8 percent.

In the years 1899 to 2002, the annual change for the Dow Jones Industrial Average was a simple 7.2 percent per year. Some investors might think that very few years had losses and that the annual returns were generally around 7 percent. But that was not the case. During that 103-year period, one-third the time the index had a loss and in only five years was the return in between 5 and 10 percent.

To get a better picture of the roller coaster ride in that period, consider that half of the 103 years had gains in excess of 16 percent or losses in excess of 16 percent; boom or bust. Grandmas don't like roller coasters; many other people don't like them either.

This is not to suggest that equities are bad. It does suggest that people

attach strong emotions and beliefs to their investments and many times the decision making is flawed. The concept is that the average investor, as well as the sophisticated investor, is not well served by emotions when investing because the asset you love, won't necessarily love you back and the truisms governing bland assets may not be so true.

Most investors do not begin "tabula rasa." They have a set of expectations for risk and return for their asset class. If someone told you over and over and over again to expect an 8 to 9 percent returns, you don't expect the variability. Have you ever heard an investment adviser say that (beyond statements of what to expect over the long term) you might get a roller coaster ride? Or that the year in which they need to use the funds, they might be 16 percent lower than the prior year? On the other hand, for those whose investment management discipline is tilted toward investment in dividend paying stocks, you will hear that the bulk of returns for a 20- to 30-year period, and all of the returns for the last 10 years, have come from dividends. Yes, the frequently boring, dividend-paying stocks. No sex appeal with them.

None of the above applies to the investor who is sufficiently skillful to outperform market averages and escape market declines. Among professional money managers, 85 percent underperform their relative index. You might be able to join the ranks of the 15 percent, but buying



one or two stocks (very selective, big position, and hopefully very successful) is not the same as broad based, diversified investing.

Some ideas for taking the emotions out of investing? Have a diversified asset and income base. A diversified equity portfolio is not a diversified asset base. Secondly, attempt to assign various terminal values to your investment and assign probabilities to each. Can't entertain the idea that there could be a loss? Then, please reread this article. Can you withstand this loss? At least you are now entering the relationship knowing that there is a chance you can get burned.

How to get off the emotional roller coaster of investing? A prescription for the ladies might be to adopt as a mantra from Tina Turner: "What's love got to do with it?" ■

— Jeannette Rohn Showalter is a South-west Florida-based chartered financial analyst, considered to be the highest designation for investment professionals. She can be reached at [jshowaltercfa@yahoo.com](mailto:jshowaltercfa@yahoo.com).

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