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March 9, 2011, 12:01 a.m. EST



Bull-market birthday is no reason to invest

Investors can make case for many happy returns, or none at all

By [Chuck Jaffe](#), MarketWatch

BOSTON (MarketWatch) — In 2009, investors were worried about fallout from the credit crisis, the subprime mortgage debacle and a sluggish economy. In 2011, investors are worried about fallout from international political unrest, looming problems in municipal finance, and a sluggish recovery.

At any time, and in any conditions, investors have something to worry about. Two years ago, amidst those worries, the stock market started an impressive bull-market run. Many investors had to talk themselves into participating. Today, many investors are jumping into the market — as witnessed by heavy mutual-fund flows into stock funds — and many investors are wondering if they should be talking themselves out of participating.



Bargains for stock investors

Value-stock investors can find buying opportunities in any market climate. Michael Scanlon, co-manager of John Hancock Large Cap Equity Fund, talks about three stocks he sees as bargains: Microsoft, Sirius XM and Lazard. Jonathan Burton reports.

the Flash Crash in May, when investors got a reminder of how swiftly fickle the market can be. While few investors suffered long-term portfolio damage from that brief market blow-out, they all got a fast, jarring look at the worst that could happen.

Throw in all of those other worries and investors stayed on the sidelines.

While the herd seems to be moving into the market now, the herd is notoriously bad at figuring out when to invest, typically waiting too long to be convinced that the market is moving in a certain direction.

It's easy to undermine investor confidence in an environment where interest rates appear ready to start rising — and potentially sooner than most people expect — where inflation is likely to head up too, and where politicians may feel that the best way to deal with daunting budget deficits is to raise taxes enough to where the average person feels the pain.

“People say we have great danger now, but it’s not any more dangerous now compared to 2008 or 2009,” said Meir Statman, a pioneering researcher in behavioral finance and author of the new book “What Investors Really Want.”

“What has been amazing is how frightened investors have remained, despite the recovery that has already occurred,” he said. “People tend to extrapolate from recent events, and what has been vivid in people’s minds is not the rise since March 2009, but the decline of 2008.”

Flash Crash dashed investors’ hopes

Investors seemed to be ready to break out of that shell a year ago, when in-flows to equity funds were on the rise along with the market, only to see everything derailed by

In times like these, pros like to say “it’s a stock-picker’s market,” but that’s ridiculous, because it’s always a stock-picker’s market. While a rising tide can lift all stocks and turn even bad strategies into money-makers, savvy strategies and insights never go out of style.

Opposing views

What’s more, investors will soon be looking at numbers with the memory of 2008 distant enough to no longer be an impediment. Come September and October, as the carnage of 2008 fades, many mutual funds will have great three-year track records.

“The U.S. stock market will begin to compare very well to the bond and emerging stock markets,” said David Brady of Brady Investment Counsel in Chicago. “This will no doubt attract risk-averse investors to U.S. stocks. If things play out this way, we could see the real momentum beginning in the second half of 2011.”

You don’t have to look far to find an opposite viewpoint.

“The upside potential doesn’t seem to be large enough as compared to the downside risk,” said Michael Falk of Michael S. Falk Asset Consulting, also of Chicago. “However, that in no way means a rally cannot occur, but rather that [investors] would need to time their exit well — which is unlikely — to make it worthwhile to take additional risk at this point.”

For most investors, entering the third year of a bull market is less about buying opportunities or scaling back than it is about comparing a portfolio to its target allocations, to get back onto the plan.

During the market’s downturn, few investors rebalanced their portfolio. They let their losses accumulate or their winners run, but they didn’t bother to try to get back to their planned allocation because it involved buying stocks when they were ugly or pulling back on bonds when bond funds were going strong.

Effectively, those investors — the ones who stayed the course rather than pull everything out — were giving in to their emotions a little bit, doing what they had to in order to feel comfortable with their portfolio.

With all of the nervous energy surrounding the market right now, giving into those emotions again, but in a controlled way, is probably what will make investors most comfortable. It gives them permission to follow the herd into stocks, up to a point, while backing them away from the most interest-rate-sensitive investments.

Effectively, the idea at a time like this — with the market potentially ready to reach an inflection point at some point in the not-too-distant future — is to balance fear and greed, and not to give in to either.

Both of those emotions are devilish to investors, who are easily beguiled by the prospect of missing out on good times and who are scared of giving anything up, even if it happens in the course of a normal market cycle.

“If you give in to some emotions, that’s not bad, so long as you just give in a little bit, enough to feel comfortable with your ability to deal with the market,” Statman said. “It’s when you get rid of all stocks or all bonds that you are acting as if you know what the future will bring, and no one really does.

“Oh, they’ll tell you they do,” he added. “All you are hearing because of the bull-market’s anniversary is people who think they know what will happen next, but most will be wrong and a few will be right by accident or sheer luck,” he said.

“You’ll find out later who is right and who is wrong and where the market really goes,” Statman said. “In the meantime, you should have a diversified portfolio that you believe in no matter what happens next.”

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