Sailing in a Secular Bear Market

Jack Davidson

I can't sail. Perhaps it's because my family had no tradition of sailing. In my youth, summers were spent by occasionally going to Jones Beach and getting a sunburn that qualified as third-degree.

It may be that sailing simply takes too much patience. I am also not an investment manager. I see a trait in sailors and investment managers that I admire. Both can tack. They have learned that sometimes the fastest way to cross the finish line is to select the slowest route. That's how I feel we are today in our management of bonds. Our managers regard yield much as sailors deal with breezes. Do we head to where there is virtually no breeze and perhaps avoid the seductive winds that take us off course?

The managers know that today's low bond yields will increase sooner or later. That's a given to them. So, staying short in high quality holdings is part of a strategy of getting the best return in the long term. Our course is measured over a decade, not a year. Sometimes the managers feel a need to do something more; maybe take a little more risk. How can we earn our keep by purchasing short-term bonds that have almost no yield? I sometimes feel a need to remind them that we want to cross the finish line with the lead boats.

Our managers need to be busy on the stock side, too, and especially agile in equity selection. That doesn't mean we should abandon our buy-and-hold philosophy of quality holdings. It does mean that we should be mindful of diversification. Diversification requires agility, and by that I mean proper diversification, not over-diversification. Were we in a secular bull market, we could simply ride the S&P ~ but we are not. The debate right now is not whether we are in a secular bear market. It is more about when it started. Did it start in 2000 or 2008? The starting date is important to some of us because *secular* bear markets run in very long cycles, unlike *cyclical* bear markets, which tend to average between two and ten months. The last secular bear market lasted sixteen years.

Whether we are right or we are wrong about the secular bear market, our strategy of appropriate diversification should work in all types of markets. We plan on doing this with a combination of individual stocks (30 to 35 holdings) and electronically traded funds (ETFs). And we will monitor the diversification. We do not want to mimic the S&P 500. The following chart illustrates the risk of doing so:

	Annualized Return	
Time Period:	1966-1981	1982-1999
Type of Market:	Secular Bear	Secular Bull
Length in Years:	16 Years	18 Years
Annualized Returns by Asset Class:		
S & P 500	6.00%	18.50%
Small Cap Value	14.80%	18.40%
Small Cap Growth	10.50%	13.70%
Large Cap Value	11.00%	17.40%
Large Cap Growth	5.10%	17.70%
Long Term Govt Bonds	2.50%	12.20%
Long Term Corp Bonds	2.90%	12.00%
30 Day T Bill	6.80%	6.20%
Inflation Index	7.00%	3.30%

Our principal focus will be stock selection and asset allocation. And, as always, it will be with a long-term view. We plan on being with the lead boats. That said, the 1966-1982 secular bear market included eight rallies that ranged from 16% to 76%. So we also expect a bumpy ride, but if history holds true we would like to assure our clients that they will not need a life preserver; Dramamine, on the other hand....................