



## WISDOM SHOULD OUTWEIGH WORRY

BY THOMAS CURRAN

Over the past year I have been writing about how and why investors' confidence has been shattered by economic events leading up to the financial crisis/panic of 2008 and 2009. After each mention of the assault on our net worth, I always repeat the following: Great bull markets have followed each financial panic dating from the late 1800s. There have been five of them and after each of the previous four, great bull markets followed producing annualized returns exceeding 15%.

The last great bull market began when inflation was out of control and short-term interest rates reached 20%. There was severe economic distress in the late 1970s and early 1980s exacerbated by the recognition of energy shortages and OPEC's emerging power over the economy. To the surprise of most, a great bull market "rose from the ashes" and endured for about 20 years.

Beginning in 1981 the market averaged almost 19% annualized for nearly 20 years.

Another example of unlikely and inconceivable market performance was: Following the 1929 crash, the stock market from 1932 through 1938 rose almost 500% measured by the Dow Jones Industrial Average.

History tells us investor psychology is very predictable. People invest based on how they

feel. When they are frightened like they are now, they sell stocks. At best they hold and seldom increase holdings. When people are over confident like they were in the 1990s and 1920s, they buy stocks. In the 1990s the new economy made economic recessions extinct, benign, or so people believed. Now they believe economic depression is likely to be long and end the world economy as we know it.

I began my career in financial services in 1969. My experience now includes four full decades and parts of two more. What I have learned is experience and wisdom is worth more than money can buy. Money will buy fancy presentations to include "facts" and glossy charts, but it does not buy wisdom. Time is the only "currency" for acquiring wisdom. And if time has served me well then the wisdom I have now tells me we should all be aggressively buying high quality companies whose stock prices tell us more about the past than they do about the future.

The challenge before all of us is to fend off the emotion of fear with wisdom. Franklin Delano Roosevelt said on March 4, 1933, "The only thing we have to fear is fear itself." Truer words were never spoken. I wonder how many investors paid attention in 1933.

When FDR was inaugurated the unemployment rate was more than 20%. The world feared

economic collapse. Europe was uneasy with nationalist sentiment driving forces that eventually led to World War II.

In spite of all the negatives the stock market was facing during the Great Depression, the Dow Jones Industrial Average increased 4.5 times from July 1932 through August of 1937. The stock market went up approximately 35% annualized over a five year time frame. The world endured. In spite of all the troubles, the USA survived and prospered.

Our opinion is the current market is recovering more quickly than investor confidence. As we have discussed many times, the recovery is likely to take place even as news regarding employment and housing continues to be disappointing.

The United States is entering an economic period when saving and investment is becoming the primary priority. As a result, there will be less income spent on consumption. Our expectation is savings and investment will gradually increase over at least the next 10 years. As a result, consumption will decline. Investment and saving is not nearly as much fun as consuming. It is however, the best way to pay for our recent profligate spending. We have exhausted the option to borrow now and pay later.



It is a characteristic of wisdom not to do desperate things.

Henry David Thoreau (1817-1862)





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For those who expect a recovery to be stimulated by domestic consumption, as in past recoveries, they are likely to miss a great bull market which is now in its early stages of development.

A casualty of increased savings and investment is employment. Curran does not expect the recovery to depend upon a full recovery in the employment rate. Anecdotal observations indicate most businesses are still finding excess capacity in spite of maintaining lower than expected employment rates. In other words productivity continues to improve. The increase in employment will come later than hoped in this recovery.

In the long run the stock markets are driven by growth in GDP and corporate earnings. GDP growth in the past was driven by domestic consumption. In the future earnings are likely

to be driven by export growth fueled by savings and investment.

The bearish case being made by many analysts today is supported by the lack of current data showing increased consumption and employment growth. Our bullish case is based upon fundamental changes in spending and investment patterns, not by recent economic experience. To resurrect a pattern for consumption that is largely responsible for the problems we face today is not a long-term solution. It is obvious to us that we must enter a period when long-term solutions (saving and investment) are prescribed and adhered with discipline. It is less obvious that such a prescription is being followed or is even necessary in the "eyes" of the market. We believe it is and will be for many years to come.

**OUR CORE STRATEGY**

We continue to recommend the purchase of high quality equities. Curran restates we are very negative regarding the outlook for all long duration fixed income securities. We recommend fixed income investors continue to hold lower yielding short-term securities because we believe inflation risk is too high to buy longer term bonds that are paying insufficiently higher interest rates.



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