



## Lessons From History

by Thomas Curran

As a nation, many of us strongly doubt the banking system's ability to manage risk over the long run. Throughout history, banks and bankers have been making tragic errors in judgment that are most easily explained by their greed and lack of conscience.

The mood of the nation and the world indicates we clearly recognize the seriousness of the crisis. To get a better understanding of our present predicament, consider the worst ten year calendar year results ending 12/31 since 1920 in the stock market. There were 88 ten year periods to be considered including last year.

In all, four of the ten worst periods occurred in the 1930s (1932, 1937, 1938, 1939). There was one occurring in 1920 and another in 1940. There were four in the 1970s (1974, 1975, 1977, 1978).

How bad were those decades? Well, two of the ten experienced negative annualized returns while eight recorded positive returns. The worst was 1938 (-0.89% annualized) and the best of the worst was 1977 with the market advancing 3.59% annually.

In the worst decade, \$10,000 invested on December 31, 1928 was worth \$9,144 by December 31, 1938.

In the best of the worst decade, \$10,000 invested on December 31, 1967 was worth \$14,229 by December 31, 1977.

Now, there is one more decade we need to address; the ten years ending December 31, 2008. It was the worst ten year period, even worse than 1938. The annual rate of return was -1.38%. This means that \$10,000 invested on December 31, 1998 was worth only \$8,702 ten years later.

As investors we must have reasonable expectations for sustainable returns over the long run. We at Curran believe 10% is a reasonable expectation for stock market returns over a long period of time. If we did not previously know it, we now know the stock market can and does perform at rates significantly less than its long term average of about 10%.

Perhaps the most important question to be asked is: What should we expect after a decade of miserable stock market performance?

Here the news gets considerably better. Consider the returns for the following ten years after each of the worst ten year results, as presented in the chart to the right:

Year	10 Year Trailing Returns	Following 10 Year Return
1938	-0.89%	7.26%
1939	-0.05%	9.17%
1937	0.02%	9.62%
1974	1.24%	14.76%
1940	1.80%	13.38%
1932	2.90%	9.34%
1978	3.16%	16.33%
1920	3.24%	14.12%
1975	3.27%	14.38%
1977	3.59%	15.26%

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*"A banker is a fellow who lends you his umbrella when the sun is shining, but wants it back the minute it begins to rain."*

**- Mark Twain**

## Lessons From History (Continued from page 1)

When one of the worst decades has occurred, it was always followed by a decade with much higher returns.

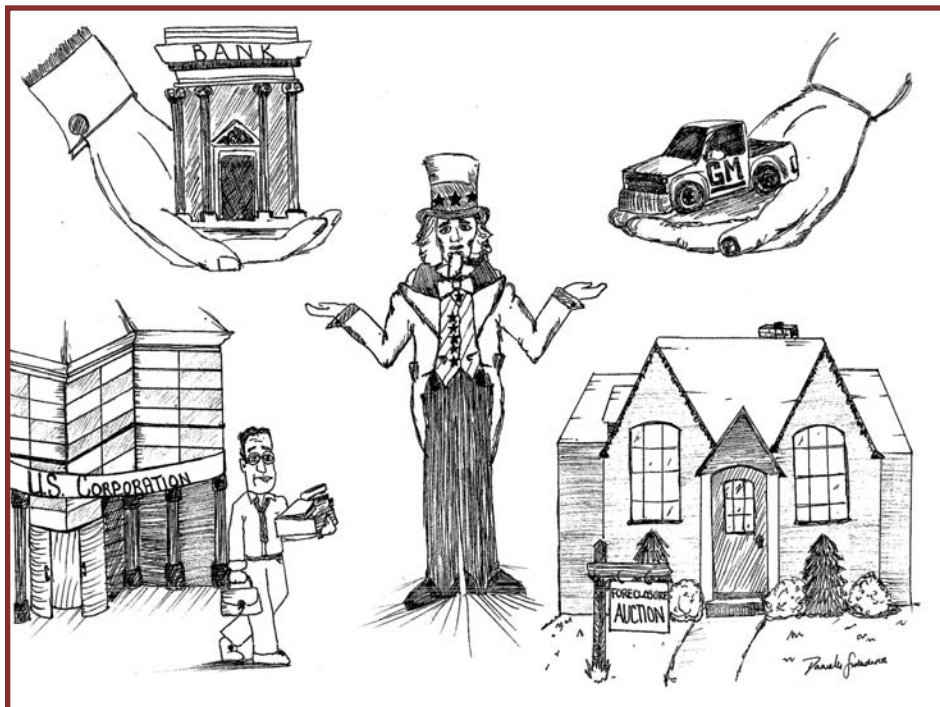
1938 provided the lowest results following a ten year decline. \$10,000 invested in 1938 grew to \$20,154 over the next decade. The best year for investing in our example was 1977. Over the next 10 years \$10,000 grew to \$41,379.

What do we know from the history of the stock market dating to 1920?

- Markets go down over what seems to be long periods of time.
- Markets go up even more over longer periods of time.
- Markets have always provided high positive returns following a decade of declines.
- Markets are not behaving differently today than they have in previous crises.
- Investors are not behaving differently either. They are frightened today as assuredly as they were in previous times of crisis.

What should we do? Learn from history. History is telling us the future is better than we may be thinking!

*Tom*



### Albany Office:

Omni Plaza 30 South Pearl Street  
Albany, NY 12207  
(518) 391-4200  
(866) 432-1246  
(518) 391-4242 Fax

### Philadelphia Office:

2101 Market Street, Suite 2002  
Philadelphia, PA 19103  
(518) 391-4210

### Cape May Office:

621 Lafayette Street  
Cape May, NJ 08204  
(609) 884-1560  
(609) 884-2697 Fax

### Thomas Curran

President & Chief Investment Officer  
(518) 391-4291  
tcurran@curranllc.com

### Lisa Clifford

Senior Vice President  
Director of Marketing & Business Development  
(518) 391-4292  
lclifford@curranllc.com

### Kevin Curran, CFA

Vice President & Director of Research  
(215) 923-9920  
kcurran@curranllc.com

### Andrew Black

Wealth Management Strategist  
(518) 391-4280  
ablack@curranllc.com

### Chip Prestigiacomo

Relationship Manager  
(518) 391-4267  
cprestigiacomo@curranllc.com

### Cristina Scheid

Relationship Manager  
(518) 391-4226  
cscheid@curranllc.com

### Anne Riley

Relationship Manager  
(518) 391-4248  
ariley@curranllc.com

### Teri King

Portfolio Administrator  
(518) 391-4244  
tking@curranllc.com

### Danielle Saladino

Marketing Associate  
(518) 391-4237  
dsaladino@curranllc.com

### Molly Garner

Operations Administrator  
(518) 391-4270  
mgarner@curranllc.com

Illustration: **Danielle Saladino**

Newsletter design: **Mark E. Lang, TBEdesign.com**