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WEALTH MANAGEMENT, LLC

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Stock Market Lessons from the
Loma Prieta Earthquake

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While many of our clients reside in California, even those who live outside the Golden State have unsettling memories of the 1989 Loma Prieta earthquake. That earthquake's devastating impact lives in our collective conscious, whether we recall the shocking images of the Bay Bridge collapse or perhaps the World Series disruption.

For Californians, though, the reality of surviving the quake is especially vivid. While time has lessened the fear that gripped the state during and immediately after Loma Prieta, it is important to learn from the quake experience. Immediately after the quake, most people took stock of what they had. They called loved ones, picked up children from school, secured food and water. Once they secured their immediate safety, people waited for the aftershocks.

Following the initial earthquake, numerous aftershocks greater than 4.0 on the Richter scale were recorded. Any time the earth shook, people ran for cover expecting the worst. It took many months, but eventually life returned to normal for most of us. Today, quakes registering below 4.0 do not cause concern and barely get covered by the media. While we are still wary of earthquakes, our fear of them is far less pervasive than it was 22 years ago.

People's attitudes towards earthquakes are not that different from their investment attitudes. In 2008, we were riveted by one of the most violent movements of the market in our lifetimes. What was our first reaction to the precipitous market decline? ***Fear!***

Many investors were paralyzed — scared to be in the market, but also afraid to get out. Other investors panicked and fled for "safe haven" investments. Many bailed in October 2008 when the Dow was down to 8,200. Some stayed invested in October and November 2008 only to be chased out by the "aftershocks" in February 2009, exiting the market when the Dow dropped to nearly 6,000.

Source: Yahoo! Finance

Even as the market rose in 2009, numerous financial commentators and purveyors of "investment pornography" continued to predict a "double dip" recession. People waited nervously for the other shoe to drop in 2009 and even 2010. January and February of 2010, as well as June and July, saw particularly nerve-racking aftershocks. Spurred by continuing fears of the double dip recession, many investors continued to nervously wait.

The double dip did not come in 2009 or 2010, just like the great quake of 1989 did not lead to greater earthquakes. Those that did not panic were rewarded. Many of our clients are close to regaining the peak account values of 2007. While they may have lost four years, many are not worse for the wear, and we believe they are well positioned to ride out the next storm, however, violent it may be.

Since the end of World War II, the stock market has gone through long periods of droughts followed by long periods of historic gains. The years 1945 through 1964 saw a 591% real rate of return (net of inflation) in the stock market. Thus even with discounting for inflation, a dollar in the S&P 500 would have grown to $6.91.[1]

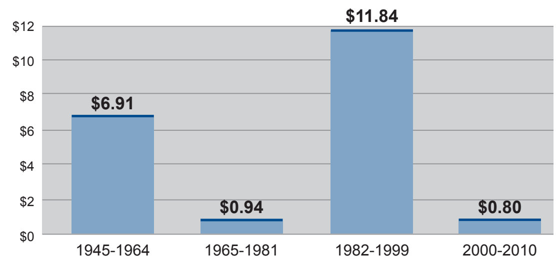
The period from 1965 through 1981 was a completely different story. A dollar invested in the S&P 500, adjusted for inflation, would have declined to 94 cents, a -6% return.[2] In other words, the market lost virtually a decade and a half. Again, with the price of oil skyrocketing under newly formed OPEC's control in the early 1970s, many people fled the stock market. But the investors who ran for cover in the late 1970s missed the market boom that ran from 1982 through 1999.

History has shown repeatedly that downward markets don't last forever, and recovery inevitably follows. From 1982 through 1999, we saw one of the best periods in stock market performance. During the boom, most people latched onto their favorite stocks or mutual fund. The real return was nearly 1100%.[2] One dollar would have grown to $11.84 in inflation adjusted dollars.

Following this 18-year boom came the "lost decade" of 2000 through 2010. A dollar invested in the S&P 500 in 2000 would have been worth 97 cents by the end of 2010, or just 80 cents if you factor in inflation for this period.[2] During this time period the real return on the S&P 500 was almost -20%. Nobody could have predicted the tech bust followed by a stock market run up only to be followed by the housing bubble, and a near collapse of the banking system.

Earthquakes, like down markets, will happen. But we recover from them. We rebuild and continue with our lives.

Real Growth of a Dollar



Source: Ibid

We believe that the best way to weather major market shake-ups is to make sure that you are adequately diversified. Having exposure to developed international markets, emerging markets, fixed income, and small and large stocks are the best way to ensure that you are minimizing risk while maximizing reward. Diversification will not protect an investor completely from down market cycles, but it can help the investor stay in the markets long enough to see a recovery.

The most important principal is be true to yourself. If you are more concerned about risk than trying to maximize rates of return, it is crucial let your Advisor know so your allocation can be set accordingly. Nobody can dictate someone's feelings about risk and investing. The better you and your Advisor define your tolerance for risk, the more rewarding your investment experience is likely to be.

If you have any questions about risk and return in your portfolio please contact us at (408) 260-3138 or arubin@werbarubin.com.