InvestmentNews
The Leading News Source for Financial Advisers

Market volatility fuels confidence crisis

Advisers adopt long-term perspective in wake of wild ride

Jeff Benjamin
September 22, 2008

The extreme stock market volatility kicked off a week ago when the Dow Jones Industrial Average dropped more than 500 points underscored the fear spreading across the investment community, leaving financial advisers scrambling for answers and sound advice.

In a week during which the industrials ultimately ended about where they started, there was a tendency to reflect on past stock turmoil for either comfort or perspective.

"If you just drew a line through the market from the early 1990s through 2005 and you ignore all the stuff that happened in the middle, it would be a very even upward trending line," said Henry Sanders III, a portfolio manager with River Road Asset Management LLC, a Louisville, Ky.-based firm that manages $3 billion.

Last Monday's 504-point decline ranked as the sixth-largest single-day drop in the history of the index.

On a percentage basis, the 4.42% decline ranked as the 96th worst of all time.

A 449-point drop two days later — the seventh-largest ever — drove the index to its lowest close in almost three years.

'CONFIDENCE GAME'

"It's just a big confidence game, and unfortunately all the confidence is gone right now," said Mr. Sanders, who cited a popular mantra for times like these: "Don't just do something; stand there."

Most financial advisers have tried to adopt a similar long-term perspective even during a week when some of the nation's most substantial financial institutions exposed dire balance-sheet vulnerabilities.

"Ten years from now, it won't matter if you got into the market now or last month or next month," said Jeffrey Dunham, chief executive of Dunham & Associates Investment Counsel Inc., a San Diego-based firm with $1 billion under management.

Even while emphasizing the fact that much of the damage on Wall Street has so far been contained to the financial sector and that other market fundamentals remain positive, advisers recognize that investors aren't not yet thinking of the long term, or even the medium term.

"Confidence is what it will take to find a bottom in the short term, and to get there we need six months of no more bad news," Mr. Dunham said.

Meanwhile, a case was also being made for taking advantage of the stock market's most recent beat-down and realizing that there are segments that might suddenly be dramatically undervalued.

With the industrials dropping to the 10,600 range by midweek, it represented a 25% decline from the 52-week high of more than 14,164 on Oct. 9.

"You can't tell me those companies are worth that much less right now," Mr. Dunham said.

That kind of attitude could help encourage market stability.

"In the near term, this is all going to lead to increased volatility. But if we can get past this, I can see the market turning around in the fourth quarter, and I see a nice rally in the first quarter of next year," said Kevin Mahn, chief investment officer at Hennion & Walsh Asset Management Inc., a Parsippany, N.J.-based firm with $300 million under management.

"Fortunately, this is still contained to the financial sector, and that's why it's getting to the point of a really attractive buying opportunity for some stocks," he added.

The bigger picture, however, involves the general cleansing effect that the fallout is likely to have on the markets.

"Right now, we're going through a process of creative deconstruction where we're redefining Wall Street," said Tom Sowanick, chief investment officer at Clearbrook Financial LLC, a Princeton, N.J.-based firm with $22 billion under management.

STIMULUS IN PLACE

"I still think the market will be higher by the end of the year and a year from now because there are some [economic] stimulators in place," he said.

Considering that inflation and unemployment remain relatively low and there is an expectation of lower interest rates from the Federal Reserve, the case is being made for a rally from what could be the bottom — assuming no more big surprises.

"The more the markets are allowed to work things out, the better," Mr. Mahn said. "Before you know it, it'll be the end of October, and we'll all be talking about the election again."

Of course, such a rosy outlook doesn't fly with everyone.

"We have to have our finger on the market's pulse and be willing to go to cash at times like these," said Brian Schreiner, vice president of Schreiner Capital Management Inc., an Exton, Pa.-based firm with $185 million under advisement. His technical research drove him to a 65% cash position two months ago.

"Going to cash is not a silver bullet, and we can get whipsawed. But right now, nobody has a clue what's going to happen in the market, and a lot of people are pretending they do," Mr. Schreiner said.

"We believe everything from a 1929-style crash to a rally is in play, and we need to learn to live in that range of possibilities," he said.

Negative sentiment, as has been vividly illustrated by the stock market's recent volatility, is a necessary part of the cleansing process, according to Mr. Dunham.

"The market will continue to fall until there is so much buying opportunity investors can't help themselves anymore," he said. "If you're a long-term investor and if you're going to invest in the equity markets, these kinds of pullbacks are seen as salivating opportunities."