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# THE PETE ANDRESEN INVESTMENT NEWS

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## LIVING HISTORY

When I was a child, I used to read about the marvelous old days and wonder what it would be like to live in an era of such adventure and uncertainty. As a beginning professional investment advisor in the mid-1980's, I used to listen to grizzled veterans discuss the 1930's or the 1970's financial crash and wonder how a person could financially survive such turmoil.

One reason we could look back on these exciting eras in history with such abstract fascination was that we had the advantage of 20/20 hindsight. From an investor's perspective, we could look back and see a bull market in stocks and say, "There, that's where it began." At the time, however, investors had no idea what was actually taking place in a market they were watching daily. We can now review charts of historic data and identify market tops in 1929, 1972 or 1987. And we can spot bottoms, too: each point at which a stock market ceased its decline, began its slow, uneven recovery, and laid the groundwork for a future bull market. None of these events was clearly identifiable at the time.

These complete market cycles each defined a generation of investors, and they carried with them vast lessons about investing. However, it seems to take us humans at least twenty years to get the emotional distance to rationally analyze any event or epoch. For example, we just recently genuinely understood what happened in the conflict in Vietnam. In a similar way, we are just beginning to recognize the social sea change that constituted the Reagan years of the 1980's. These years laid the groundwork for all the goodness, missteps, and excesses that characterized the last twenty years.

What we have just experienced, what we are now recovering from, is an event of great magnitude. You and I can't really see that in our daily lives, but I believe deeply that it is nonetheless true. You and I have lived through the very infancy of the technology revolution that will utterly transform the world and sweep away all before it.

From an investor's point of view, we have participated in the blind groping of capital markets seeking a way to price this new technology. Mistakes were made, speculation ran wild, and not a little of what went on was fraud.

In other words, it was a classic stock market cycle of gigantic proportions, rich with all the cross currents and eddies of human motivations, driven by the new wave of innovation that would come to transform our world.

In this way it resembled the coming of the railroad, the introduction of the automobile, the marketing of radio, or the arrival of any new technology in the history of these United States. Capitalism apparently cannot embrace the new without riotous excess. It is just the way we are.

Yet, as we rise in the morning and look in the mirror, are we not the veterans now? As events shaped our ancestors, are we not shaped and molded down to the very center of our being by what we have experienced?

Regardless of our personal chronological ages, we are the societal product of personal computers, dot-com's, cell phones, bio-tech, and finally 9/11. Our cultural journey has been every bit as valid as any survivor of the Great Depression, World War II, or the "go-go" 1960's. If you don't believe that, try telling anyone who was within five miles of "ground zero" on 9/11/01 that Pearl Harbor was worse. The two experiences stand on their own, within their historic contexts. They are both equally genuine and unique.

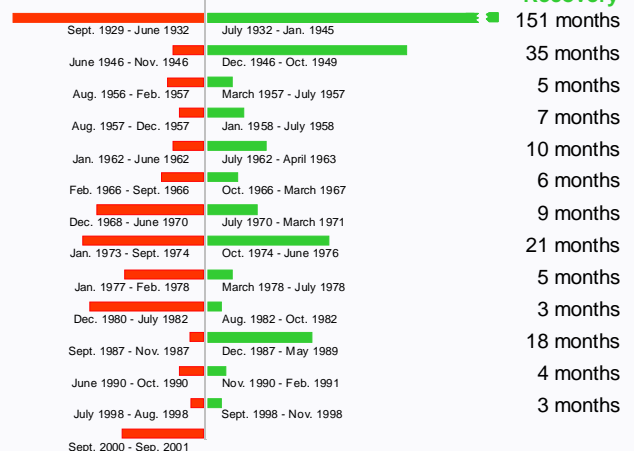
Likewise, I feel that it is appropriate to compare the tech bubble and its subsequent meltdown to the "Roaring '20's" bull market and the resulting Great Depression. For many investors, our technology stock crash has been as damaging as the Great Crash of 1929. The rest of us have survived relatively financially intact, yet we are left with a survivor's visceral uncertainty. On a primitive level which transcends comparison, we are feeling hurt, nervous, and scared. This post-traumatic stress was also a relic of past great crashes, and we are feeling it now.

### Market Downturns and Recovery

1926-2001

#### Downturn

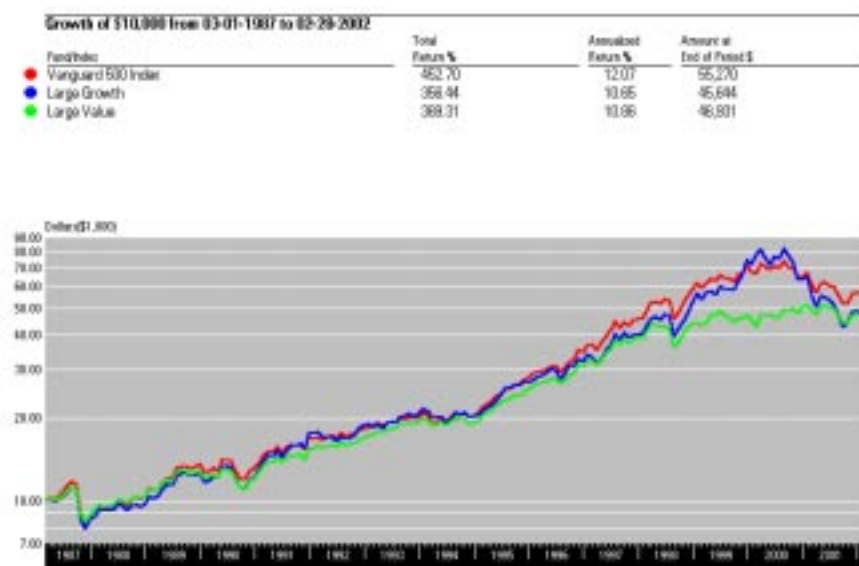
34 months	-83.4%
6 months	-21.8%
7 months	-10.2%
5 months	-15.0%
6 months	-22.3%
8 months	-15.6%
19 months	-29.3%
21 months	-42.6%
14 months	-14.1%
20 months	-16.9%
3 months	-29.5%
5 months	-14.7%
2 months	-15.4%
13 months	-30.5%



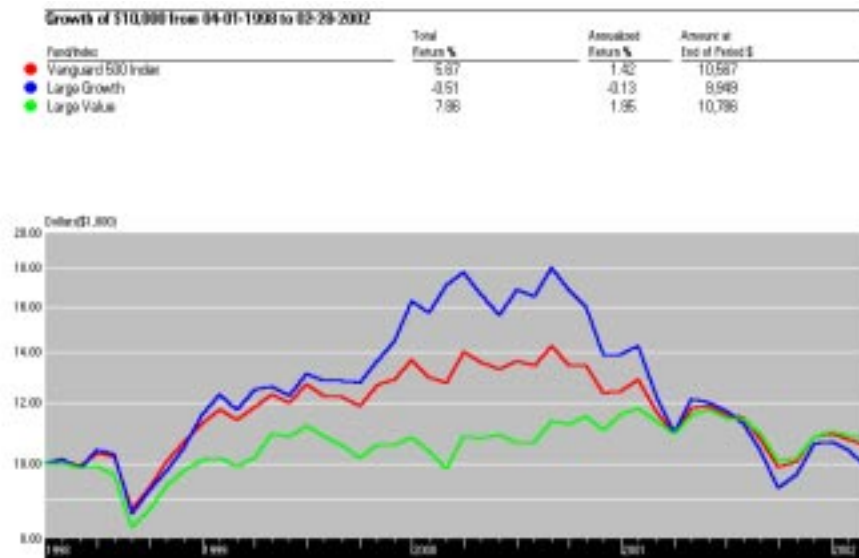
We don't know what will happen next. I often refer to history, but it is an imperfect guide. Nonetheless, in most cases it is our best indicator of what to do next, as long as we stay alert for what is different as well as for what is similar. What first shouts at me from the experience of the past is the advantage of setting aside, as much as possible and as quickly as possible, the rawness of our emotions. We need to study what has just happened, know why we are where we are, and act as rationally as possible.

There are immense advantages to being able to do this, but most people just can't escape their feelings. This appears to be one major reason why many people are not financially successful. As I said before, it seems to take society in general at least twenty years to wrap its collective brain around the history of an era and determine what really happened. In this case, however, there are immense financial and social benefits from individual objectivity. The advantages are too numerous to list. Let's review just two.

**Graph 1: In a full market cycle, Index outperforms Growth.**



**Graph 2: In a bubble environment, Value beats both Index and Growth.**



Back in the '60's, all of us knew investors who had been scarred by the Great Depression. Their usual response was to loudly label the stock market as a rigged financial casino on the Hudson River, a giant roulette wheel managed by smarmy Wall Street hucksters. From the standpoint of their individual experiences and the urban mythology of the crash, they were right. However, from a greater perspective based on a more reasoned investment strategy, they were horribly wrong.

As you can see in the chart on the previous page, there have been many U.S. equity market downturns over time with varying levels of severity and different lengths of recovery periods. The most severe downturn marked the start of the Great Depression, where stocks lost over 80% of their value. In this case, the recovery period was over 12 years. It is evident that stocks are prone to sudden declines in value. These declines seem to happen at random, and there are many different reasons offered for stock market crashes and bear markets. Often, the decline is preceded by a period of high returns which lull investors into a false sense of security. But of course, once the recovery was complete, history tells us that the stock market consistently made a higher return than any other liquid investment commonly available.

Another product of the glory days of the 1920's was the modern mutual fund. Created in part as a marketing gimmick for the cluelessly affluent, it was newly possible to create a mutual fund because of innovations in communication. In other words, it was now possible to create, maintain and price a relatively complex portfolio of stocks. Basically, however, the mutual fund was a vehicle for rampant "plunging", as speculation was termed. Mutual funds were largely a tool for speculation, not investing.

However, in the aftermath of the great crash of 1929, it was apparent that something new and successful was afoot. Stripped of its speculative aspects and anointed with conservative management, the new mutual fund became the most innately successful stock market investment vehicle of the 20<sup>th</sup> Century.

Now we have our own complete market cycle to consider. Most investors will be unable to set their emotions aside and study objectively what has just happened. We don't have all the information yet, but there's enough to get a rough picture of what we have lived through. Some dominant social ideas will be swept away...the concept of "new economy/old economy" comes to mind. Some innovations will rise to prominence.

For example, this was the first full market cycle for the mature index fund. As you can see (Graph 1), its performance in the complete cycle is surprising: it outperforms growth funds as predicted. Surprisingly, however, it falls behind much more conservative value funds in a "bubble" environment (Graph 2). This is completely the opposite of what the "Indexing-Is-All" Mavens were expecting.

There is much to learn here. In order to thrive and prosper, we must strip away our impatience, prejudices, emotions, and reactions.

Welcome to the new millennium. We are now officially part of history. 🇺🇸