

What if they gave a rally and no one came?

Third Quarter 2012

The third quarter was a strong one for the US stock market, and continues a strong bullish run since the market bottomed out from the Great Recession in March of 2009. In fact, according to Reuters¹ the S&P 500 has risen 133% since the bottom in March 2009. At the same time, September 2012 was the thirty-ninth consecutive month with net redemptions in equity investments. According to CNBC² September 2012 was the best September since 1999, yet it appears the net equity redemption continues. This clearly demonstrates that investors are their own worst enemy: markets are at or near the all time highs reached in 2007 (except for the NASDAQ), yet many investors still believe that the markets are going down because their own accounts have not recovered.

The math is simple. Those investors who have not recovered are those who participated in the mass exodus from equities rather than enjoyed the more than 100% turnaround that the equity markets rewarded to patient investors. This reinforces the long term and consistently bad behavior of investors selling low and buying high. To make matters worse, not only are investors pulling money out of equity but they are placing the funds in bonds (where interest rates are hovering near their all time lows).

The week of September 19th saw the second largest investments in junk bonds ever³. The average investor hasn't noticed that these investments are called junk bonds for a reason. It's possible they believe the name change intended to make these investments seem less risky - high yield bonds. We no longer have to ask the question "Are investors rational?" There is too much evidence to the contrary.

But the question remains: are we going to let our behavioral irrationalities control our financial destiny? Since the market crash of 2008 to 2009, investors have reacted to the perceived risk of equities by moving large amounts of money into bonds and other fixed income investments, completely ignoring the specific risk of fixed income investing. The longer the maturity of a bond, the higher the likelihood that it will be very volatile when interest rates do rise, which is inevitable. While I cannot tell you when this will occur, we are hovering around the lowest interest rates of our lifetime, and when interest rates are extraordinarily low, eventually they will rise.

¹ Sept 29, 2012

² CNBC.com Oct 1, 2012

³ Bloomberg.com Sept 21 2012

Yes, there is some rational fear that we will have another recession. Ironic then, that the same investors who believe that a new recession is possible are the ones investing in junk bonds -- the one class of fixed income investments that would be hurt the most if a new recession hit.

Fortunately, we have not been persuaded by consumer activity. In my nearly thirty years of advising clients on managing their goals and their money, I have discovered that more often emotions rather than information control our actions. Being aware of this is the most important part of properly investing to reach our goals.

As you look at your third quarter reports you will see that cautious but sound investing is much more rewarding than responding to greed and fear.

May the rest of the year be kind to you and yours, and of course if you have any questions, please feel free to call.

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Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs and expenses. Past performance is not a guarantee of future results.

Fixed income investments are subject to various risks including changes in interest rates, credit quality, and other factors. Securities sold or redeemed prior to maturity may be subject to a substantial gain or loss. In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities.

Lower rated debt securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal.