

Rocky Start

April 2, 2009 – As bad as the stock market's performance was during President Bush's final quarter in office, it was worse still as President Obama took the reins. The Dow Jones Industrial Average fell to 6,469.95 in March, and the S&P 500-stock index slipped to 666.79, levels last seen in the last century, when Alan Greenspan famously warned of "irrational exuberance." That's a 54% drop from the high set in October 2007; the only worse period for the stock market in modern history was the 89% drop in the Dow from 1929 to 1932.

And then, over a three-week period, stocks took an upward sprint, gaining over 20%. By the usual rules, that would define the start of a new bull market. But these are not usual times.

Despite the strong March showing, this was the worst first quarter in 70 years. Investors wonder whether a new bottom was set in March, or if another downward leg could be triggered by disappointing earnings results.

To be included in the S&P 500, a company must have a market capitalization of \$5 billion. At least, that was the rule in 2008. As share prices crashed, Standard & Poor's twice lowered the floor, settling it at \$3 billion. Even so, in March, 136 of the 500 companies in the index were valued at less than the minimum.

Signs of life

The stimulus bill enacted in February will take some time to work its magic – if it does. In the mean-time, there were some glimmers of hope:

- Retail sales in January were up a revised 1.8%, the first gain in seven months. Sales fell in February by 0.1%, less than many expected, and if cars are taken out of the picture, sales rose 0.7%.
- New housing starts rose 22% in February, with building permits up 3%.

On the other hand, home prices fell sharply in January. The auto industry continues to suffer, whipsawed by the volatility of gas prices. Consumers have lost their taste for small cars just as car companies have ramped up production of those vehicles. Everyone is hurting – at then – current sales rates in March, GM had a 427-day supply of Chevrolet Aveo subcompacts; Toyota had a 175-day supply of Yaris subcompacts; and Honda had 125 days' worth of Fits. Hybrids no longer are commanding premiums either.

The long road back

The most unsettling fact of life for investors is the exceptional level of volatility in the stock market. Indices moved up or down by 2% or more on 33% of the trading days in the first quarter, more than double the 15% rate of the year-ago quarter. Still, that was a big improvement over the final quarter of 2008, when the market moved by 2% on 61% of the trading days.

If the worst economic news is behind us, how long will it take for the stock market to recover fully? Most likely, a very long time.

After the crash of 1929, the Dow Jones Industrial Average took a quarter century to set a new high. More recently, 7.2 years elapsed from the start of the 2000 bear market to a return to the previous peak, and it took 7.5 years to recover from the market break that began in 1973. The current bear market began on October 9, 2007. If the seven-year number holds true, we won't return to a new peak until 2014. But that implies double-digit returns for the next five years.

Historically speaking, stocks gain about 38% during the first 12 months of a bull market. Did we really touch bottom in March? If that is the case, today's depressed prices could prove to be bargains in the long run.

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