

April 1, 2011

The Power of Patience

It was yet another solid quarter for the stock market, ending with a gain of just over 5% for the S&P 500. This marks its best 1st quarter performance since 1998. Despite a mid-quarter sell-off of approximately 7% sparked by mid-east unrest centered on Egypt and Libya, the bulls were able to extend the gains of 2010. Fund flows, a measure of sentiment, show that investors continue to move from bonds into equities, pushing prices higher. Economic data suggests that while the recovery is far from robust, growth is returning to many sectors of the economy. Corporate earnings remain in an uptrend, although at a somewhat slower pace than in previous quarters. Tempering the enthusiasm is a housing industry that cannot find a bottom, which in turn contributes to a stubbornly high rate of unemployment, as well as energy prices that keep creeping higher.

It was exactly one year ago today that our 2010 spring newsletter titled The Power of Dividends was published. In that piece we noted that investment strategies built upon the concept of total return, have, over time, proven to be wealth builders for those willing to weather the vagaries of the financial markets. We firmly believe that the ability to withstand domestic and world events that shake investors' confidence is vital to long-term success in the stock market. Time and again the term "get me out at any price" has proved to be the downfall of many who invest in equities. War, oil price shocks, and financial chaos are some of the major factors that affect investor sentiment, and with today's 24/7 media coverage it only exacerbates the challenge to remain disciplined. We thought that it might be of interest to look at some major historical events that have affected the markets, and measure their impact on prices.

Unrest in the mid-east is nothing new. In August 1990 Iraq invaded Kuwait, an action that was met with international condemnation, and touched off what history refers to as Gulf War I. Economic sanctions were imposed on Iraq by the United Nations Security Council, and a coalition of forces were deployed to oust the invaders from Kuwait. (Does this sound familiar?) After a series of aerial bombardments followed by a ground assault, the Iraqis were expelled in early 1992 and peace was restored. In the face of a conflict that could have had far ranging implications, the stock market stood firm, and in the year following the end of the conflict the major stock averages had gained more than 10%.

In 1998 the markets did a dress rehearsal for the 2008 financial collapse when Long-Term Capital Management, a Greenwich, Conn. hedge fund imploded. Some of Wall Streets "best and brightest" relied on computer models thought to be flawless, and believed that leverage was the road to higher profits. (Does this sound familiar?) A bond market correction in the summer of 1998 sent LTC's investments into a tailspin and the fund lost almost \$4.5 billion overnight. Fearing a market collapse, the Fed intervened, and within a matter of weeks the crisis passed. The event triggered a sharp sell-off in stock prices with the S&P 500 falling some 15% that summer. One year later the index had recouped all of its losses and stood more than 15% above the pre-crisis level, with a significantly larger gain when measured off the market low during the fiasco.

Oil price shocks are a subject that could fill many pages. Some of us (Bill & Bob, but not Andrew) can recall long lines to get gas during the 1973 oil crisis. In response to US involvement in re-supplying Israeli military forces, OPEC, along with some other oil-exporting countries, declared an oil embargo against the United States. In the early part of 1974 a settlement was reached and the embargo was lifted. In the years since then there have been many exaggerated moves in oil prices, the most recent being in 2008 when oil was priced at over \$140 per barrel. After a subsequent decline to about \$40, oil now stands at just over \$100 per barrel. It is interesting to note that inflation adjusted oil prices today are less than at the peak of prices back in 1979. It seems that economies can prosper in the face of volatile and often uncertain energy markets.

There are many other examples of events that can shake the financial markets: the sharp rise in interest rates that brought on the “crash of 87”, the high-tech boom and bust of the 90’s, and the flash crash of May 2010. Through all of these, the market has endured and remains a viable venue for wealth building. The “power of patience” allows investors to weather the most uncertain of times.

Lest we appear to be no more than market cheerleaders, there are concerns. Fiscal deficits, surging food and energy prices, disasters in Japan, and the impending end of the Feds quantitative easing this June, along with the aforementioned residential housing situation to name a few. Job creation remains elusive, and the unemployment rate is hovering around 9% a full 21 months after the end of the most recent recession. Stock selection is key, and here at Abbot we will use periods of market weakness to accumulate equities we feel are ripe for price appreciation in the months ahead.

1st Quarter Scoreboard 2010

Dow Jones: +6.4%

S&P 500: +5.4%

NASDAQ: +4.8%



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