# Sara-Bay Financial Corp.

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## **<u>"The Beauty or the Beast?"</u>**

If you have been in the stock market for more than a decade, you know the Market can be either of these. Late in 1999, I was in my office talking with a businessman and prospective client. A mutual fund salesman had shown him what I refer to as "mountain charts," which displayed the performance of certain funds for the previous five years. As you will remember, 1994 through 1999 was a period of a powerful bull market; "the beauty." The man said, in all seriousness, he didn't think he needed investment guidance. He was going to buy an index fund, which tracked the Dow Jones Industrials and he would be content with the gain of 18% to 22% a year that it would produce. The following year the market became "the beast!"

A bear market is a subject assiduously avoided by large brokerage firms, bank trust departments, and most investment people in general. Merely broaching the subject rankles their disposition to the point of annoyance, and if you are able to elicit any comment at all it is something to the effect that "we are not in one now," or "yes we already had one, but we are currently turning the corner and expect the market to go to new highs," or that you should simply buy some funds that move with the general market, hold on, and stop asking questions. Is there a vested interest here? If you want an impartial or non-prejudicial response, don't ask a group of realtors what they think home and condo prices will do this year. Since a bear market is such a touchy subject, I believe it is time we address it.

First, so we are all on the same page, let me give you my definition of a bear market. If you look up the term bear market, you will likely find many other definitions. Here is mine:

> It is not a market where stocks are constantly falling, rather it is a period where the popular averages make only minor new highs or are unable to score any new highs at all. Bears come along after massive bull moves when it has been easy to make money, and the stock market looks better than almost any other investment. They begin when optimism is near its highest levels and they can last for several years. During bear markets, prices will suddenly and unexpectedly retreat sharply, giving investors a jolt of fear. As these periodic drops occur, pessimism continues to grow among investors until it reaches its pinnacle somewhere near the end of "the beast." When investors reach the point of disillusionment and despair, the transition to a new bull market will unobtrusively make its appearance. The averages will quietly and inexplicably begin to rise only to gather momentum as time passes.

As you have may have surmised, it is our opinion that we are not quite ready to escape the bearish influence that started about February of 2000. The sharp rise in the averages over the last three years has left us wary of investing new money since early this year. In January of 2000, the Dow dropped from a high of 11,900 to about 7,500. From that low three years ago, it has rallied back and in May of this year went over 11,500. We believe current valuations to be high and have been making our views clear to our new investors. We have told them we are not planning to invest all their money right away and most of our established managed accounts have more cash than we would normally maintain.

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It is the investment policy of most trust departments and money managers to stay fully invested and immediately commit all funds given to them. Many have a Statement of Investment Philosophy, which says they are to be at least 95% invested at all times. The thinking behind this is that people do not like to pay a money manager to have their money sitting in a money market. The fact that they are always invested is another reason they claim to be bullish all the time.

I have never subscribed to the philosophy that we must always be fully invested. Clearly, our job is to take your funds and do our utmost to make them grow. But first and foremost, we are the guardians of your capital, and rule number one is to protect your money. In short, if we can't make it, don't lose it!

This is a challenging business, and we recognize the possibility that our prognostications can be wrong. If that is the case, we must adjust our thinking, lick our wounds, and move forward aggressively. But our current plan is to wait and continue to search for the opportunities. There are indicators that I use every day, as well as a few more I record weekly. In addition to monitoring several economic gauges, I have spent many hours pouring over the patterns and the nuances of past bull and bear markets. While the past is never a guarantee, it can provide invaluable guidance. As Yogi Berra said, "You can observe a lot just by watching."

People who own mutual funds whose objective is to mirror a particular index such as the Dow or S&P become very discouraged during bear markets. These index funds go down with the market then go up when the market advances. As a result, the account values generally go nowhere. They come to the conclusion they could have done just as well or better owning money market accounts or certificates of deposit without the accompanying worry. For our mutual fund clients, this is the reason we recommend funds with diversified portfolios, and meticulously avoid index or certain sector funds. In our managed accounts, we are buying the shares of individual companies and bear markets provide the absolute best buying opportunities. The cream does rise to the top and declining markets provide the most favorable times to find the new rising stars.

We have gone through difficult markets before, and we will certainly see them again. As Yogi said, "It's like déjà vu all over again." But, opportunities will arise and it is our best guess we may see a good one within the next two to three months. Meantime, we will continue to search for the bargains - the golden nuggets of the next bull market.

Sincerely,

Mike

J. Michael Hard

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