

DOWN TO THE WIRE

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A Look Back at 2012

Although many investors have expressed frustration with stock market fluctuations in recent years, the time required to recover losses from the October 2007 peak appears broadly consistent with past cycles.

It took nearly 4½ years, but the cumulative wealth of an S&P 500 strategy with dividends reinvested finally reached an all-time record (measured on a month-end basis) in March 2012, and finished the year 3.3% above the previous high-water mark set in October 2007. Results were slightly better for a small-company Russell 2000 strategy: As of December 2012, cumulative wealth was 8.5% higher than the previous peak in May 2007.

The table at right shows how many years were required to achieve a new high in terminal wealth during some of the major market cycles in the past. Although many investors have expressed frustration with stock market fluctuations in recent years, the time required to recover losses from the peak in October 2007 appears broadly consistent with past cycles. We can draw some measure of solace in acknowledging that past generations of investors often found their patience sorely tested, as well.

Market Cycles Based on Month-End Value of S&P 500 Index with Reinvested Dividends

Peak Month	Trough Month	Loss at Trough	Recovery Month	Years to Recovery
Oct 2007	Feb 2009	-50.9%	Mar 2012	4.4
Mar 2000	Sep 2002	-43.8%	Oct 2006	6.6
Aug 1987	Nov 1987	-29.5%	May 1989	1.8
Dec 1972	Dec 1974	-37.2%	Jun 1976	3.5
Dec 1961	Jun 1962	-22.3%	Apr 1963	1.3
Feb 1937	Mar 1938	-50.0%	Mar 1944	7.1
Aug 1929	Jun 1932	-83.4%	Jan 1945	15.4

Every year brings its share of surprises. Perhaps the biggest surprise of 2012 was the strength in stock and bond prices around the world despite a steady stream of discouraging news events. Individual investors and professionals alike were often flummoxed by markets that failed to behave in accordance with their pessimistic assessment of the future. A few examples are listed below.

(Index performance data represents total return for each respective three-month period.)

FIRST QUARTER 2012**S&P 500 Index: 12.59%****MSCI World ex-USA Index: 11.34%**

“Investors go into 2012 hunkered down, frustrated, and skeptical. ... If there is a common theme among analysts’ forecasts for stocks, commodities, and currencies, it is to brace for more of the wild swings that were the hallmark of 2011.”

Tom Lauricella, “World’s Woes Leave Lasting Scars,”
Wall Street Journal, January 3, 2012.

“Morgan Stanley’s chief US equity strategist is the most bearish market strategist at any major Wall Street firm when it comes to forecasting the outlook for stocks in 2012. He took the same pessimistic view last year—and it turned out to be the most accurate.”

Jonathan Cheng, “A New Year But the Same Ol’ Pessimism,”
Wall Street Journal, January 7, 2012.

“Clearly we are in a cycle of reaching pinnacle earnings, and at some point we are going to drop.”

Quotation attributed to John Butters, senior analyst, FactSet.
Michael Mackenzie and Ed Crooks, “Earnings Growth Falts for S&P 500,” *Financial Times*, January 9, 2012.

“The world economy will experience a brutal slowdown. ... Every European country will be in recession in 2012, and probably in 2013. ... Equity markets around the world will top out during this quarter and then enter the next down leg in the cyclical bear market that started last spring.”

Quotation attributed to Felix Zulauf, Zulauf Asset Management.
Lauren R. Rublin, “Barron’s 2012 Roundtable, Part One,” *Barron’s*, January 16, 2012.

“Unemployment in the euro zone jumped to a 15-year high Thursday, while inflation unexpectedly accelerated.”

Brian Blackstone, “Poor Economic Data Slam Europe,”
Wall Street Journal, March 2, 2012.

SECOND QUARTER 2012**S&P 500 Index: -2.75%****MSCI World ex-USA Index: -7.38%**

“Nearly one Spaniard in four is unemployed, according to data released yesterday, as the country’s financial predicament prompted a government minister to talk of a ‘crisis of enormous proportions.’ ”

Victor Mallet and Robin Wigglesworth, “Spain Jobless Rate Nears One in Four,” *Financial Times*, April 28, 2012.

“Suddenly it has become easy to see how the euro—that grand, flawed experiment in monetary union without political union—could come apart at the seams. We’re not talking about a distant prospect, either. Things could fall apart with stunning speed in a matter of months, not years.”

Paul Krugman, “Apocalypse Soon,” *New York Times*, May 18, 2012.

“Feeble hiring by US employers in May roiled markets and dimmed the already cloudy outlook for an economy that appears to be following Europe and Asia into a slowdown.”

Josh Mitchell, “Grim Jobs Report Sinks Markets,”
Wall Street Journal, June 2, 2012.

“Greece will be forced to return to the drachma and devalue, and the default will cause bank runs and money flowing into Germany and the United States as the only viable safe haven bet.”

Quotation attributed to Mark J. Grant, managing director, Southwest Securities. Andrew Ross Sorkin, “One Wall Street Seer Says the Greek Tragedy Is Near,” *New York Times*, June 18, 2012.

“With leading investors shunning shares, a six-decade passion for equities has come to an end—leading to a less flexible, more conservative model of corporate financing.”

John Authers and Kate Burgess, “Out of Stock,” *Financial Times*, June 24, 2012.

“There is no natural flow into equities for the next five to 10 years. The rules of the game have changed.”

Quotation attributed to Andreas Uttermann, Allianz Investment Management. John Authers and Kate Burgess, “Out of Stock,” *Financial Times*, June 24, 2012.

“The quarterly rite known as earnings ‘preannouncement’ season is under way—and so far it isn’t boding well for stocks. ... The downward revision in [earnings] guidance could portend a long slog for stocks and the overall economy, say analysts.”

Joe Light, “Earnings Bode Ill for Stocks,” *Wall Street Journal*, June 30, 2012.

THIRD QUARTER 2012

S&P 500 Index: 6.35%

MSCI World ex-USA Index: 7.49%

“Investors already fretting about the health of the world’s biggest economies now face another worry: disappointing earnings. ‘The pillar of strength is US corporate earnings, and now we’re seeing signs that that is cracking,’ [says Morgan Stanley’s chief stock analyst].”

Jonathan Cheng, “New Jolt Looms for Investors: Earnings,” *Wall Street Journal*, July 9, 2012.

“The US economy slowed sharply in the second quarter, growing just 1.5% as consumers slashed spending and businesses grew more cautious about hiring and investing, underscoring that an already wobbly recovery is losing even more steam.”

Neil Shah, “Weak Economy Heads Lower,” *Wall Street Journal*, July 28, 2012.

“If small investors needed any more reason to be disgusted with the stock market, they got it Wednesday.”

Neil Shah, “Weak Economy Heads Lower,” *Wall Street Journal*, July 28, 2012.

“Wednesday’s tumble wasn’t quite as scary as the nearly \$1 trillion drop of May 6, 2010, but it conveyed the same sense of markets spinning out of control and trading machinery gone mad.”

Jason Zweig, “When Will Retail Investors Call it Quits?” *Wall Street Journal*, August 2, 2012.

“The global slowdown in demand is hitting the manufacturing sector in the world’s largest economies, with activity sinking to its lowest level since June 2009, when most industrialized countries were mired in recession.”

Norma Cohen, “Manufacturing Hits Three-Year Low,” *Financial Times*, August 2, 2012.

“Activity in China’s manufacturing sector—the engine for much of Asia’s economy—shrank at the fastest pace since the depth of the global financial crisis.”

Arran Scott and Alex Brittain, “Manufacturing Downturn Spreads Gloom across Asia, Europe,” *Wall Street Journal*, September 4, 2012.

FOURTH QUARTER 2012

S&P 500 Index: -0.38%

MSCI World ex-USA Index: 5.89%

“The slowdown in the global economy and anemic US recovery are expected to result in one of the worst US quarterly earnings seasons since late 2009.”

Mahmudova and Michael Mackenzie, “Slowdown Set to Take Toll on US Earnings,” *Financial Times*, October 8, 2012.

“This is unquestionably the worst earnings season relative to expectations that we’ve had in two or three years.”

Quotation attributed to Chris Jones, J.P. Morgan Asset Management. Jonathan Cheng and Kate Linebaugh, “Weak Earnings Spark Selloff,” *Wall Street Journal*, October 24, 2012.

“Wall Street’s post-election stupor is turning into a real headache for some stocks, as many well-known and even ballyhooed names fall into bear market territory. ...

Nearly a quarter of the stocks in the Standard & Poor’s 500—122—are in a bear market, unofficially defined as a 20% decline from a recent high.”

Matt Krantz, “Big Name Stocks Hit Bear Markets,” *USA Today*, November 9, 2012.

“China’s main stock index closed at its lowest level in almost four years Tuesday and slipped below a key psychological level, indicating investor worries over the health of the nation’s public equity market.”

Shen Hong, “Shares Hit 4-Year Low in China,” *Wall Street Journal*, November 11, 2012.

“Fears that Washington will prove unable to avoid looming tax increases and spending cuts have eclipsed concerns about Europe’s debt crisis, top business executives said Tuesday, and they worry that political gridlock might tip the economy into recession next year.”

Damian Palette and Sudeep Reddy, “Business Leaders Spooked by Fiscal Cliff,” *Wall Street Journal*, November 14, 2012.

“Moody’s downgrades France sovereign debt rating, citing its ‘persistent structural economic challenges.’”

William Horobin, “France Loses Another Top Rating,” *Wall Street Journal*, November 20, 2012.

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