

A Turbulent Year in Review

The art and science of investing can generate some spirited discussions, but most people cannot help but notice one of the most intriguing aspects of investing: the long-term disconnect between world events and the behavior of investment markets. Every day, we hear that the markets have gone up or down as a result of some dramatic event or piece of economic data in the news. But if Rip Van Investor had fallen asleep at the start of the 20th century, and awakened with a yawn 100 years later at midnight, December, 1999, he would have been startled to see that his investment in the S&P 500 had gained more than 10% a year, on average, during his 100-year nap. He might fairly have concluded that he'd slept through ten decades of happiness, sunny economic climate and smooth sailing, when in fact the century included two horrible world wars, the Great Depression, the Cold War, the disastrous war in Vietnam, stagflation, a presidential assassination, impeachment hearings, the rise of global terrorism, and the truly disturbing social trend of reality TV.

The year 2011 proved to be a microcosm of this odd-but-important investing lesson. If you had gone to sleep on January 1, awakened on December 31 and immediately checked your U.S. stock portfolio, you would have seen the most boring possible outcome: stocks basically unchanged for the year. The Standard & Poor's 500 index finished the year exactly 0.04 points below its level prior to the opening bell on January 1, 2011. That translates to almost exactly a 0% total return. That means it was a boring, uneventful year for investors--right?

In fact, this less-than-inspiring stock market performance was achieved in the most exciting possible way. Remember August, when the average spread between the highs and lows on the S&P 500, per *day*, was an astonishing 3.39%? Remember all the political bickering over raising the U.S. debt ceiling, when we worried that the United States government was teetering on the brink of default? Or how the S&P credit evaluators stripped the nation of its AAA rating? Yet somehow, despite the best efforts of our politicians, a broad index of U.S. government bonds gained 9.6% for the year.

All year long, we heard one gloomy report after another on housing and real estate, yet the Wilshire REIT index gained 9.24% for the year.

In 2011, we watched the European Union teeter on the edge of collapse, the sovereign debt contagion spreading from Greece to Spain and Italy. Yet the international EAFE index of developed foreign markets closed the year with a quarterly gain of 2.86%, cutting an international investor's losses down to 14.82% in dollar terms. (EAFE's emerging markets index, the trendy investment choice for many pundits at the start of the year, was down 20.41% for 2011.)

Amid the Arab Spring uprisings and regime changes in Egypt, Tunisia and Libya, constant tensions over the nuclear program in Iran, the terrible tsunami tragedy leading to a nuclear catastrophe in Japan, and the recent unpredictable regime change in nuclear-armed North Korea, it seemed like every other week there was a reason for investors to believe that the markets would finish 2011 well below their pre-crisis levels.

It's true that portfolios that held foreign stocks would have shown overall losses for the year. But the bigger picture, here in the U.S., is: Why is there such a broken connection between tragedy, political turmoil and scary headlines, on the one side, and market returns on the other? The answer may be that the underlying forces driving our economic growth are more stable than the headlines suggest. Quietly, despite the best (or worst) efforts of Congress, the U.S. unemployment rate has steadily declined from over 10% at the peak down to 8.6% last month, its lowest level in three years. Factory output is rising, consumer spending has been surprisingly strong, and for the first time in decades, the U.S. is a net energy exporter.

Profits, economic growth and jobs are ultimately created by the ingenuity and hard work of millions (or, globally, billions) of people who come to work every day, put their heads down and accomplish the things set before them. Rip Van Investor would have told you that this drive and initiative was the really big story of the 20th century, more important than wars, recessions and political bickering. This human initiative, that has taken us from cave dwellings to the modern electronic age, is also the underlying force that powers the markets. In the face of increasingly complicated world events, it is more important than ever to take a bit of perspective and see the long term trends behind the scary headlines and the dips and swirls of the markets.

The major U.S. market indices avoided a downturn in 2011 after two strong recovery years. Those who bailed out after the market took any of its many tumbles would have risked missing the year's many improbable, unpredictable recoveries. Rip Van Investor came out all right--and suffered a lot less anxiety than the rest of us.

We at LongView want to help you make sense of the dichotomy between today's immediate headlines and your long term investment goals. We thank you for your continued support and want you to always remember our motto: "Wealth begins when you take the LongView".

Indices mentioned are unmanaged and cannot be invested into directly. Past performance is not a guarantee of future results.