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## **Strategies for a Down Market**

In the last eight months, the Dow has dropped more than 20 percent. What is a prudent investor to do now? Tips for advisors revealed.

July 24, 2008  
*by Neal Frankle, CFP*

Have you received calls from frantic clients lately? Have they been pleading with you for advice on what to do in this stock market? If so, I'm not surprised.

You are your clients' most trusted financial advisor and they look to you for guidance during periods of financial turmoil.

Let's review what has happened over the last quarter and how you can help your clients now.

Most stocks and funds ended the second quarter with sharp losses. Rising oil prices and damaged financial firms gave investors plenty of reasons to be concerned. The Dow Jones Industrial Average (Dow) lost seven percent in the second quarter and 14 percent year-to-date. The S&P lost slightly less, hardly much solace to investors. Small cap funds and stocks held up slightly better than large cap. Growth did a little better than value. But at the end of the day, there have been few safe places to hide for investors so far in 2008.

Also, while the market certainly has been difficult — partly because of the weak dollar — that weakness is helping segments of American industry. A falling dollar increases the cost of imported goods but makes our exports relatively more attractive. Exports represent 8 percent of our economy and capital goods make up 75 percent of those exports. The capital goods exporters are benefiting from the weak dollar. In fact, American manufacturers generate almost half of their revenue overseas.

Still, in the last eight months, the Dow has dropped more than 20 percent, which meets the technical definition of a bear market.

What is a prudent investor to do now? Are we closer to the bottom of the market than the top?

Of course nobody knows the answer to this but we do know that market declines are normal. Over the long-run, equity investors have been well rewarded and in fact, equities have been the best way for investors — retired or working — to beat inflation. Bonds are great for buffering a portfolio but have not consistently offered protection against inflation. The price we pay for

long-term performance is short-term discomfort. Equity prices just don't move straight up.

Market declines of five percent to 10 percent have to be expected regularly. More severe declines happen every few years — on average every 3.1 years. In fact, the S&P 500 has declined more than 20 percent on nine occasions over the last 50 years. Is it fun? No. But it is the price for long-term performance.

Growth investors historically get rewarded with high returns after periods of steep losses. When everyone becomes anxious and frightened, equity prices drop. That's usually the very worst time to abandon investment discipline. But it's understandably tough to hold on while the media bombards your clients with pessimism and all their friends are depressed about the market.

I know that it's often not easy for people to weather these types of markets. But experience tells me that changing risk allocation in response to market conditions is usually not prudent. While many people don't have an issue with risk when the market is rising, some do have a problem with risk when the market is declining. Unfortunately, like everything else in life, we must take the good with the bad.

In short, I think it's important to remember that everything runs in cycles. Healthy markets will return. Significant periods of outperformance can last several years and can result in large gains for disciplined investors. Unfortunately, major trends include periods of short-term reversals.

### **Can You Time the Market?**

Market gains occur in spurts and if your clients are not invested, they won't participate in those gains. Because a remarkable percentage of stocks' gains occur on just a handful of days, it becomes very expensive to try to time the market. A good case in point is 1987. The one-year return after the crash was 23 percent but if you missed just the five best days during the 365-day period, you would have actually lost 6.8 percent instead.

But, I also want to be very clear that buying and holding is not a good approach either. Especially after 2002, it should be painfully clear that buying and holding is no sure recipe for success. In 2002, even *The Wall Street Journal* said, "Buy-and-hold may be the last undiscovered scam of the bubble era. Individuals who have steadfastly bought and held this market right down into the sub-basement ... may finally be realizing that they're the last ones holding the bag."

In my opinion, the best approach to growth investing is having a strategy that respects market strength and weakness and moves assets into the strongest relative performing areas of the market. Historically, this has helped clients weather bad markets and grow assets in good times.

So what is a prudent investor to do in turbulent markets? Start with having the appropriate mix of equities and bonds. The portfolio management must help your clients achieve their financial goals over the long term and allow them enough peace of mind over the short term, to stay in the game.

In tough times, I believe your clients will succeed by having a strategy that moves assets into more defensive positions as the market shifts. By hanging in there, they'll be positioned to take advantage of the opportunities, the inevitable turnaround will bring.

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**Neal Frankle**, CFP, is the author of *Why Smart People Lose a Fortune: 5 Steps to Restoring Your Wealth and Sanity*. He helps affluent clients establish and implement a safety-net strategy to protect their wealth. He also helps other professionals, such as CPAs, do the same for their clients. If you would like a free monthly e-newsletter (written especially for CPAs to use with their clients so they make better investments) please [e-mail](#) Neal.

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