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Investment Lessons Learned

What a difference a year makes. Last year at this time we were watching the stock market spiral downward seemingly out of control, large public US companies were failing, real estate sales dried up and the Federal government was taking unprecedented measures to try and reduce the negative impact of all of these events. Now, a year later, the recession may be over, Washington is debating health care, rather than emergency rescue measures, the Dow, Nasdaq and S&P 500 stock indexes are all trading higher than they were a year ago and nationally, real estate sales seem to be picking up a bit. Unemployment is higher today than it was a year ago, which indicates that we may not be completely out of the woods yet, although, as a lagging indicator, the unemployment level will probably be one of the last areas to show improvement.

What have we learned in the past year? For starters, economists and others are not always correct in predicting where the economy is heading. I give them credit for trying to assess what they think will occur but we need to understand that they can be wrong and we need to always be prepared for major uncertainty and change.

I have long preached the wisdom of diversification to my clients. The thought was always that if one type of investment is performing below average, some other type of investment might be performing better than average and since we don't know how investments are going to perform, it is important to own lots of different types of investments in order to reduce our investment risks. Different types of investments have different types of inherit risk so taking just a little bit of each type of risk might reduce our overall risk and provide us with a decent, not too volatile rate of return over time.

Well, as we saw last year, all types of investments seemed to be under performing simultaneously. Both the US and international stock markets were falling rapidly. Real estate values were dropping significantly. Bond yields were falling to very low levels. Banks were (and still are) paying essentially no interest on savings accounts. And, money market funds were in danger of "breaking a buck" – falling below $1 per share net asset value (NAV). There seemed to be no place to hide. Selling stocks and sitting on cash meant the possibility of loss of principal in the money market. Buying bonds meant possibly receiving little interest. And, purchasing real estate didn't seem to be a smart move either.

I still think diversification is important. Generally, not everything is a bad investment at the same time – although it could happen again. It is also important to understand what the possible worst case scenario might be for each investment you are contemplating to ensure that you are okay taking that risk and that you can sleep at night if the worst case does occur. With any investment, the worst case is probably that the value of the investment would go to zero and be

worthless. I think many investors learned the lesson of not taking on more risk than they are comfortable with. If nothing else, investors probably have a better idea of their risk tolerance today than they did 18 months ago and hopefully they have adjusted their investment portfolios accordingly.

We have been reminded that investing in stocks is definitely a long term investment as many things can happen in the short term. We saw the stock market fall with some stock mutual funds down 40% or more in 2008. But, we have also seen a rapid recovery with the S&P 500 index up over 50% since its low in March.

While I hope we never have to go through such a traumatic investing experience again, there is no guarantee that something similar won't happen again during our lifetime. If you have a plan to follow to meet your goals, have an adequate cash reserve for emergencies, have diversified your investments and understand the risks involved in each investment, then hopefully you will be in good shape to weather the next storm.