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# THE UNPREDICTABLE MARKETS

***A Case Study…5 Years After "911"***

Just how good are you at anticipating the direction of the investment markets?

Imagine that the following global events transpired over the past five years… (Unfortunately, it doesn't take much of an imagination.)

- The country suffered the most devastating acts of terror on American soil.
- As part of "The War on Terror," the country engaged in major conflicts on two fronts: Afghanistan and Iraq (and still remains there today).
- Subsequent attacks occurred in Spain and Great Britain, while other serious plots were foiled.
- While several powerful storms impacted the country, Hurricane Katrina proved most destructive, leaving parts of Louisiana and Mississippi in its wake (never to fully recover).
- Lack of investor confidence prompted the President to replace two Treasury Secretaries (O'Neill and Snow) by a man more respected by Wall Street (Paulson).
- The Fed Chairman most trusted by many to guide the economy through tough times (Greenspan) retired and was replaced by an untested academic (Bernanke).
- A seemingly never-ending conflict in the oil rich-Middle East resulted in a new war along the Israeli/Lebanese border.
- Speculation continued that Iran, the world's fourth largest oil producer, is developing nuclear capabilities.
- Oil prices surged on the plethora of news, spiking from about $20/barrel pre-"911" to a record $78+/barrel just a few weeks before the five year anniversary.
- Gold, often considered the natural hedge against inflation, likewise soared in the aftermath of these events from $271.60 on September 10, 2001 to almost $625 just five years later.

***Global Terrorism, Natural Disasters, Inflation, Government Shake-ups…***
How would you expect the traditional stock and bond markets to react to such events?

**Stocks:**
**Logic says**…Fear and uncertainty typically lead to equity market pullbacks, particularly among the more speculative small-cap asset classes.

***Reality…****At the five year anniversary of "911", the major equity indexes each traded higher than they were the day before "911", with the small-cap Russell 2000 (+60.55% annualized) significantly leading the way.*

**Bonds:**
**Logic says** …Fear and uncertainty typically lead to a flight-to-quality into fixed income products as investors seek out the safe-haven of U.S. Treasury securities.

***Reality****…Despite some significant volatility (and an even more volatile Fed policy), the benchmark 10-year Treasury was virtually unchanged since "911" (4.83% vs. 4.80%).*

***The Markets – Five Years Later…***

| **Market/Index** | **9/10/01** | **9/11/06** | **% Change** |
|---|---|---|---|
| Dow Jones Industrial | 9,605.51 | 11,396.84 | 18.65% |
| NASDAQ | 1,695.41 | 2,173.25 | 28.18% |
| S&P 500 | 1,092.54 | 1,299.54 | 18.95% |
| Russell 2000 | 440.73 | 707.57 | 60.55% |
| 10 yr Treasury (Yield) | 4.83% | 4.80% | 3 bps |

The above case study illustrates the importance of several key investment related concepts: diversification, asset allocation, and long-term time horizons.

While many investors attempt to "time" the market and trade based on speculation about the impact of global events, often the most "tried and true" strategy involves structuring a well-diversified portfolio allocated among multiple asset classes and investing for the long-term. Those investors who engaged in such a philosophy and did not panic in the aftermath of "911" (and following the other significant events) have been rewarded for their patience with positive returns.

As always, your trusted financial advisor can work with you to evaluate your current situations, re-establish your financial goals, determine your tolerance for risk, and structure the long-term, diversified portfolio that's most appropriate for you (regardless of how unpredictable the markets may be).