Six things you should know about market cycles

November 2007

When markets are volatile and the economy shows signs of weakness, investors start to wonder about the security of their investments. Is a recession coming? What stage are we at in the business cycle? How does this relate to equity returns?

In this paper, we review the relationship between the economy, the US presidential election cycle and equity market returns; we explore the value vs. growth debate; and we revisit the case for equity investing. Based on two centuries of market data, we conclude with the following lessons:

1. Business cycles are a fact of life.
2. A bear market typically precedes an economic downturn by three to nine months.
3. It is exceedingly difficult to predict when shifts in markets will take place.
4. Diversify!
5. Mutual funds provide easy diversification.
6. In spite of all the cycles and unpredictability, equities are worthwhile.

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Where are we headed from here?

When it comes to the stock market, everyone has an opinion. Some people are predicting a global recession, precipitated by a slowdown in the US. Others believe that the bull market has a few more years left. What we do know about markets is their cyclical nature. They go up and down, and then up again.

However, investors often fail to notice a change in market direction until the trend is well underway. In 2001 and 2002, for instance, many Canadians saw their portfolios shrink significantly following the technology crash. The doom and gloom persisted into 2003 as investors worried about the effects of SARS, trade issues with the US, and the summer blackout in Ontario.

And yet 2003 was the year that the Canadian stock market began its current bull run. A survey in October 2003 showed that the vast majority of Canadians either didn't know the market had gone up over the previous eight months (January-August 2003), or thought the market had gone down, or stayed flat.[1] By the end of 2003, the S&P/TSX Composite Index had finished up 26.7%.

Canada's current bull market has been primarily driven by the demand for our commodities. After five years of positive returns, where are we headed from here? Will demand for commodities from emerging markets slow down in the short term? Will China's environmental problems curtail its growth? Will the subprime mortgage crisis in the US spark a global recession?

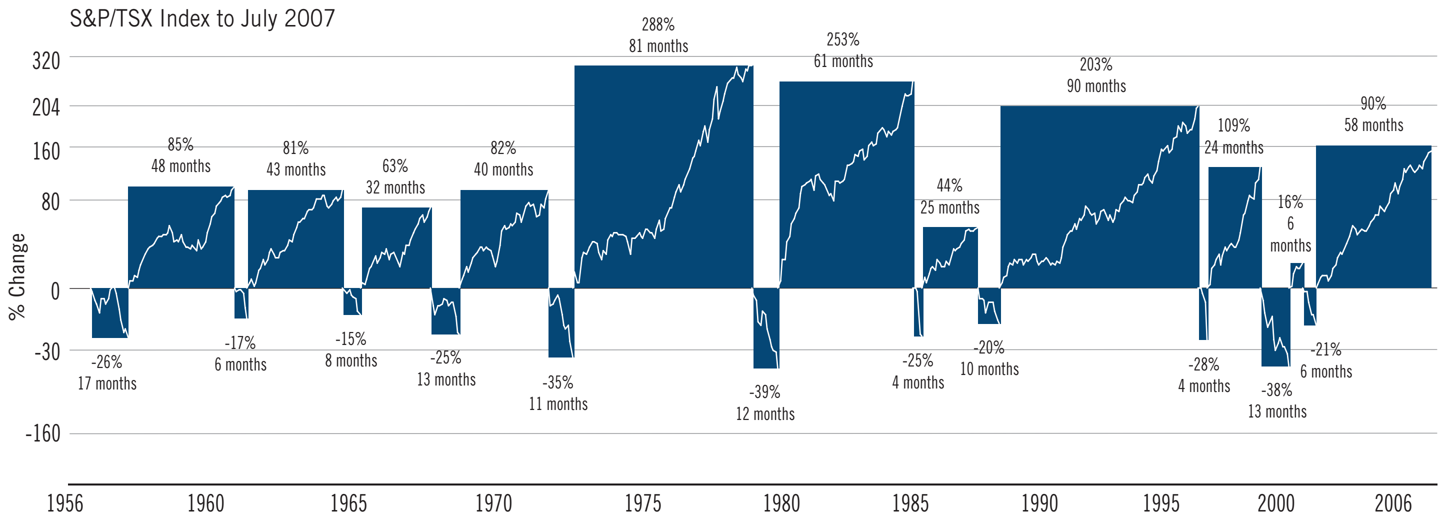
Those who know how markets work understand that no financial trend lasts forever. The stock market's cyclical nature demands a downturn at one point but no one can accurately predict what event will trigger the next bear. For any market, the challenge is in forecasting how long each phase of the cycle lasts and which events will trigger a change in direction. However, if investors recognize that markets follow a recurrent pattern, they can better manage their expectations and emotions during difficult times.

Who's up next? Bull or bear?

Cycles in the stock market are recurrent but not periodic. That means they follow a sequence of events over and over again, but these events are not repeated at regular intervals. In Canada, we had a bull market that lasted 90 months from 1988 to 1995, followed by a 4-month bear market in 1995. The market went up again for 24 months, down for 13, up for 6, down for 6, and has been on an upward trend since hitting a bottom in October 2002.

Bull & Bear Markets

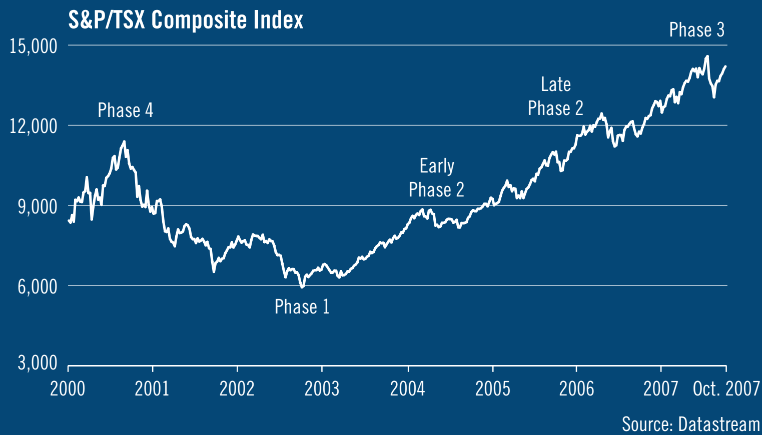
S&P/TSX Index to July 2007



Source: Mackenzie Financial (Datastream, July 31, 2007)

[1] Investors Group survey, released on Oct. 16, 2003. Of the 2,018 people surveyed, 36% said the market had gone up, 21% said it had gone down, 25% said it stayed flat and 17% didn't know.

If one divides the stock market cycle into four phases, where are we in the current cycle?



Phase 1
- Market has bottomed
- Investors are bearish
- Smart money starts to buy

Early Phase 2
- Market is stable
- Prices are slowly rising
- Media speculates whether worst is over

Late Phase 2
- More investors start to jump in
- Valuations rise significantly
- Market is euphoric

Phase 3
- Investors have mixed feelings
- Market gets more volatile
- Sentiment changes – often quickly – to bearish tone

Phase 4
- Market starts clear downward trend
- Investors are fearful and capitulate
- Market reaches a bottom

As of November 2007, the Canadian market had been on a bullish trend for 61 months and counting, notwithstanding a 12.1% correction between July 19 and August 16, followed by a near-complete recovery into late October. Our market is likely in Phase 3 as investors become more nervous about how much longer the bull market can last. The stock market cycle says that the next move is down, making this a period of intense speculation about when the market will turn and how long it will last.

CORRECTION OR A BEAR MARKET?

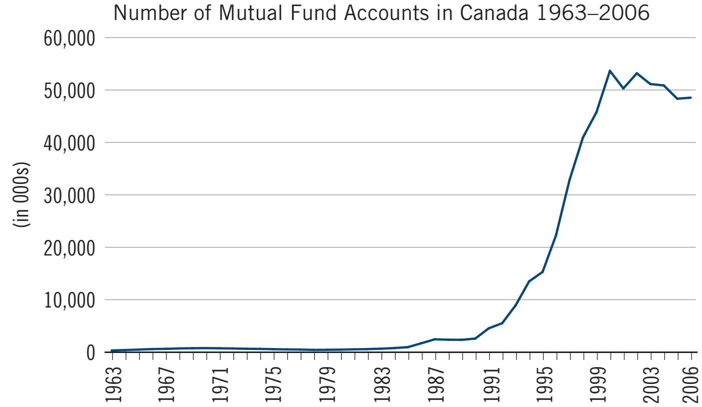
How do you know whether we are experiencing a market correction or the start of bear market? A market correction is defined as a drop of 10% to 20% over a short period of time. A bear market is characterized by declines of more than 20% across the board for a period of at least nine months.

In North America, bear markets have been relatively short. Since 1956, there have been 11 bull markets and 11 bear markets in Canada, with the average bear market lasting 10 months. In the US, there have been 10 bull markets and 10 bear markets, with the average bear market lasting 14 months.

However, the vast majority of investors in Canada have really only experienced one serious bear market following the technology crash of 2000-2002. That's because the general population did not start participating in the stock market (through mutual funds) until 1990. According to the Investment Funds Institute of Canada, there were about 2.6 million mutual fund accounts in 1990. That figure leapt to 4.5 million in 1991 and by 2000, there were 53.6 million mutual fund accounts.

Mutual Fund Accounts

Number of Mutual Fund Accounts in Canada 1963–2006



Source: IFIC

The 2000-2002 bear market may have caused damage to many a portfolio but it can also serve as a reminder to investors about how to manage their emotions and get professional guidance for their portfolios when market volatility increases and a downturn happens.

How is the stock market related to the business cycle?

Like the stock market cycle, the business cycle follows a sequence of events that is recurrent but not regular. The four phases of a business cycle are contraction, trough, expansion and peak.

A growing economy means happy times for a country. It's a period of low unemployment, stable inflation, rising corporate profits, and strong stock market activity. Naturally, a recession represents the bad times. Business conditions worsen and falling employment erodes consumer confidence. Recessions are painful and distressing, which is why their pending arrival is widely debated.

A recession is popularly defined as a decline in a country's gross domestic product for two or more consecutive quarters. For Statistics Canada, a recession must be a decline of substantial depth and duration. The U.S. National Bureau of Economic Research (NBER) defines a recession as the period between the time when business activity has reached its peak and starts to fall until the time when business activity bottoms out.

It turns out that the stock market is one of the best leading indicators of the business cycle. The current price of a stock reflects the future earnings potential of the firm. Investors buy more shares if they feel optimistic and sell if they feel pessimistic. In the same way, if investors anticipate economic growth, they will expect profits to improve and stock prices will rise. If they think the economy is going to enter into a recession, then profits will fall and so will stock prices.

With numerous investors making their guesses, they are usually right about the direction of the economy. Typically, the stock market cycle leads the business cycle by three to nine months. For instance, the S&P 500 Composite Index started its decline in September 2000 (bear market) but the recession in the US did not officially begin until March 2001.

According to the National Bureau of Economic Research, the US has never had a recession without a major bear market preceding it. However, there have been major bear markets in the US, which weren't closely followed by a recession. One example was the stock market crash in October 1987. In both Canada and the US, the markets fell by almost 23%. There were fears of an economic depression but instead, the economy continued to grow into the first months of 1990 before contracting.

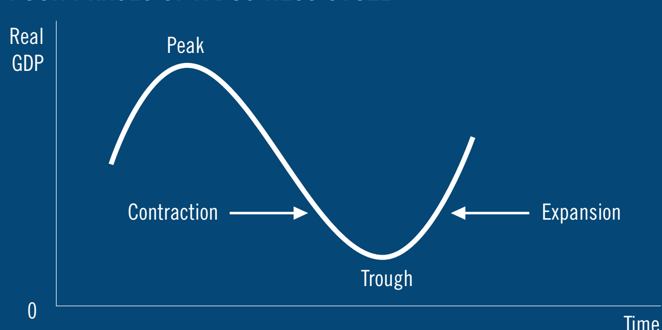
Today, investors are worrying about any of a number of catalysts that could tip the market and economy over the edge: housing troubles in the US, huge consumer debt, China's overheating economy. The markets will be watchful but chances are good that the next bear market will predict the next recession.

Can the presidential election cycle predict market direction?

If you accept the four-year US presidential election cycle, then it would seem to suggest that the stock market and business cycle are somewhat predictable.

The presidential election cycle theory says that stock prices in the US are weakest in the first two years following a presidential

FOUR PHASES OF A BUSINESS CYCLE



Contraction (Recession)
- Businesses spend less
- Workers face lay-offs
- Overall economic activity slows down

Trough (the Low Point)
- Relatively high unemployment rates
- Annual incomes decline
- Overproduction
- This period can last from several weeks to many months

Recovery/Expansion
- Business begins to improve a little
- More workers are hired
- Consumer spending rises, furthering business activity

Peak (the High Point)
- Employment, consumer spending and production are at their highest level
- A period of prosperity especially if it's long term
- At one point, demand will start to fall

election and strongest in the last two years. (More specifically, it says that stock prices decline in the first year after the presidential election, reach a trough in the second year, and peak either in the third or fourth year.)

Because investors are unsure of the president's agenda, they are anxious during the first two years of a president's term. In these first two years, the administration usually introduces changes in policy as well as tough new measures, such as budget cuts, higher taxes and interest rate hikes.

By the third year, the policies are in place and the president switches to a more favourable agenda – increased spending, tax cuts and lower interest rates. This stable environment starts the economy humming and usually in the third year, the US stock market enjoys its best time as investors anticipate a brighter economy. By Election Day, both the economy and markets are in fairly good shape so that investors/voters are going to the polls cheery.

How well does the theory stand up? Here's data from *Stock Trader's Almanac* (2008) starting from 1902 for the Dow Jones Industrial Average:

4-Year Cycle Beginning	Elected President	Post-Election Year (1)	Mid-Term Year (2)	Pre-Election Year (3)	Election Year (4)
2004	G.W. Bush	0.6	16.3	??	??
2001*	G.W. Bush	-7.1	-16.8	25.3	3.1
1997	Clinton	22.6	16.1	25.2	-6.2
1993*	Clinton	13.7	2.1	33. 5	26.0
1989	G.H.W. Bush	27.0	-4.3	20.3	4.2
1985	Reagan	27.7	22.6	2.3	11.8
1981*	Reagan	-9.2	19.6	20.3	-3.7
1977*	Carter	-17.3	-3.1	4.2	14.9
1973	Nixon***	-16.6	-27.6	38.3	17.9
1969*	Nixon	-15.2	4.8	6.1	14.6
1965	Johnson	10.9	-18.9	15.2	4.3
1961*	Kennedy**	18.7	-10.8	17.0	14.6
1957	Eisenhower	-12.8	34.0	16.4	-9.3
1953*	Eisenhower	-3.8	44.0	20.8	2.3
1949	Truman	12.9	17.6	14.4	8.4
1945	F. Roosevelt	26.6	-8.1	2.2	-2.1
1941	F. Roosevelt	-15.4	7.6	13.8	12.1
1937	F. Roosevelt	-32.8	28.1	-2.9	-12.7
1933*	F. Roosevelt	66.7	4.1	38.5	24.8
1929	Hoover	-17.2	-33.8	-52.7	-23.1
1925	Coolidge	30.0	0.3	28.8	48.2
1921*	Harding	12.7	21.7	-3.3	26.2
1917	Wilson	-21.7	10.5	30.5	-32.9
1913*	Wilson	-10.3	-5.4	81.7	-4.2
1909	Taft	15.0	-17.9	0.4	7.6
1905	T.Roosevelt	38.2	-1.9	-37.7	46.6
1901	McKinley**	-8.7	-0.4	-23.6	41.7
Total Gains (1902-2001)		**First 2 years: 218.7%**		**Last 2 years: 570.1%**	

LEGEND: *Party in power ousted, **Death in office, ***Resigned

Source: Stock Trader's Almanac 2008

Over the last hundred years (1902-2001), the total return from the first two years of a presidential term was less than half of the total return from the last two years (219% vs. 570%). If we only looked at the postwar period (1946-2001), the numbers are even more compelling: a total return of 131% for the first half and 362% for the second half.

Since 1939, the Dow Jones Industrial Average has yet to post a negative return in the third year of the presidential election cycle. In fact, the average return for the third year has been 17.2% since 1943.

While the pattern does not repeat itself exactly, it's something worthwhile for investors to keep in mind through each year of the four-year cycle. The theory would predict positive markets for US stock markets in 2007 and 2008. However, 2009 and 2010 – regardless of whether the new president is Democratic or Republican – should see comparatively weaker stock prices.

Will Growth investing trump Value soon?

Warren Buffett, perhaps the most successful investor in the world, is a Value investor. Since 1965, Buffett's holding company, Berkshire Hathaway has averaged an annual return of 21.4%. For Buffett, whose current net worth is over $52 billion, value investing will never go out of style even when the markets favour growth investing as they did in the late 1990s.

Value investors tend to be bargain hunters who look for companies that are selling for less than their estimated values. Value stocks are generally concentrated in the financial, consumer staples, utility, energy and materials sectors.

Growth investors tend to look for steadily growing companies and/or companies with the potential for strong earnings growth in the future. Growth stocks are typically represented in areas such as consumer discretionary, healthcare, media, telecom and technology.

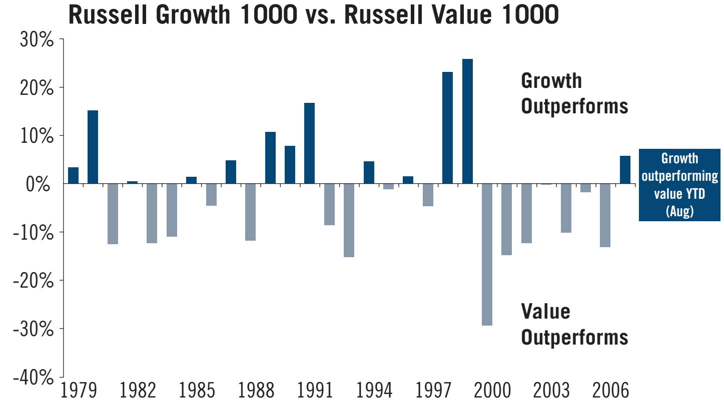
Given the long-term success of investors like Buffett, value investing is often viewed as a style that's superior to growth. When you examine historical trends though, you can see that the growth and value styles of investing exchange leadership over time.

In his book, *Common Sense on Mutual Funds,* John C. Bogle looked at growth and value mutual funds from 1937 to 1997. From 1937 to 1968, growth mutual funds outperformed value funds. But value dominated from 1968 to 1976, after which growth took leadership again until 1980. From 1980 to 1997, value was again at the forefront. In terms of performance, Bogle found that for the full 60-year period, the compound total return for growth funds was 11.7% and for value, 11.5%.

Most investors remember the late 1990s when growth investing – powered by technology stocks – significantly outperformed value. Since 2003, however, value companies (often in sectors with traditionally lower price-to-book ratios such as energy and materials) have outperformed.

The next cycle would seem to favour growth investing, especially since there has been extreme outperformance by value stocks. From the chart that shows the cumulative monthly returns of Russell 1000 Value less Russell 1000 Growth, you can see the relative performance between value and growth.

Russell Growth 1000 vs. Russell Value 1000



Source: Datastream

Over the last couple of years, the performance of value has been two standard deviations above the norm. Based on past cycles, this degree of outperformance is unsustainable and will likely reverse in favour of growth at some point. When this reversal will happen is unpredictable, but early data from 2007 suggests it has already begun.

Which sector and country will lead next year?

Spain and Italy were scarcely in the world financial news in 2006 and yet they were the top two performers among developed countries that year. According to the MSCI Country Indices, Spain's one-year return was 49.6% while Italy's was 47.0% in 2006.

Meantime, emerging markets – which were among the worst performing group in the mid-to-late 1990s – have been on a blistering pace in the last few years. They were the top investments in 2004, 2005 and 2006 with returns of 16.8%, 31.2% and 32.1% respectively.[2]

Other commodities, sectors and countries also go through cycles of positive and negative returns, taking turns in leading the way. From the chart below, you can see that out of the 16 years between 1991 and 2006, emerging markets has been at the top six times and at the bottom five times. US large caps took the number-one spot three times and the group was the bottom performer four times. Canadian large caps have been all over the chart over in the last 16 years.

As various sectors and countries exchange leadership over time, it is impossible to guess which one will be dominant in the coming year.

"Predicting the winner is difficult" (current to December 2006)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Emerging Markets 59.3%	US Small Cap 30.5%	Emerging Markets 82.3%	Int'l Equities 14.5%	US Large Cap 33.9%	Cdn. Small Cap 28.7%	US Large Cap 39.2%	US Large Cap 37.7%	Emerging Markets 57.2%	Cdn. Bonds 10.3%	US Small Cap 8.8%	Cdn. Bonds 8.7%	Cdn. Small Cap 42.7%	Emerging Markets 16.8%	Emerging Markets 31.2%	Emerging Markets 31.2%
US Small Cap 45.5%	Emerging Markets 22.4%	Cdn. Small Cap 48.3%	Global Equities 11.9%	US Small Cap 24.9%	Cdn. Large Cap 28.4%	US Small Cap 27.7%	Global Equities 33.7%	Cdn. Large Cap 31.7%	Cdn. Large Cap 7.4%	Cdn. Bonds 8.1%	Cdn. Small Cap - 0.9%	Emerging Markets 27.8%	Cdn. Large Cap 14.5%	Cdn. Large Cap 24.1%	Int'l Equities 26.8%
US Large Cap 29.9%	US Large Cap 18.4%	Int'l Equities 38.5%	US Large Cap 7.4%	Cdn. Bonds 20.7%	US Large Cap 23.4%	Global Equities 21.3%	Int'l Equities 28.9%	Cdn. Small Cap 20.3%	Cdn. Small Cap 7.3%	Emerging Markets 3.8%	Emerging Markets - 7.0%	Cdn. Large Cap 26.7%	Cdn. Small Cap 14.1%	Cdn. Small Cap 19.7%	Global Equities 20.6%
Cdn. Bonds 22.1%	Cdn. Bonds 9.8%	Cdn. Large Cap 32.6%	US Small Cap 4.0%	Global Equities 18.1%	US Small Cap 16.9%	Cdn. Large Cap 15.0%	Cdn. Bonds 9.2%	Int'l Equities 20.1%	US Small Cap 0.8%	Cdn. Small Cap 3.4%	Cdn. Large Cap - 12.4%	US Small Cap 20.5%	Int'l Equities 12.4%	Int'l Equities 10.5%	US Small Cap 18.3%
Global Equities 18.5%	Cdn. Small Cap 9.7%	Global Equities 28.3%	Cdn. Large Cap - 0.2%	Cdn. Large Cap 14.5%	Global Equities 14.4%	Cdn. Bonds 9.6%	US Small Cap 4.4%	Global Equities 18.2%	US Large Cap - 5.5%	US Large Cap - 6.5%	Int'l Equities - 16.4%	Int'l Equities 13.9%	US Small Cap 10.2%	Global Equities 6.6%	Cdn. Large Cap 17.3%
Int'l Equities 12.0%	Global Equities 4.9%	US Small Cap 23.9%	Emerging Markets - 1.8%	Cdn. Small Cap 13.9%	Cdn. Bonds 12.3%	Cdn. Small Cap 7.0%	Cdn. Large Cap - 1.6%	US Small Cap 14.4%	Global Equities - 9.5%	Global Equities - 11.4%	Global Equities - 20.2%	Global Equities 9.4%	Global Equities 7.3%	Cdn. Bonds 6.5%	Cdn. Small Cap 16.6%
Cdn. Large Cap 12.0%	Cdn. Large Cap - 1.4%	Cdn. Bonds 18.1%	Cdn. Bonds - 4.3%	Int'l Equities 8.6%	Int'l Equities 6.7%	Int'l Equities 6.5%	Cdn. Small Cap - 17.9%	US Large Cap 14.2%	Int'l Equities - 10.6%	Cdn. Large Cap - 12.6%	US Small Cap - 21.1%	Cdn. Bonds 6.7%	Cdn. Bonds 7.2%	US Large Cap 1.6%	US Large Cap 15.7%
Cdn. Small Cap 11.6%	Int'l Equities - 3.0%	US Large Cap 14.7%	Cdn. Small Cap - 8.6%	Emerging Markets - 7.8%	Emerging Markets 6.6%	Emerging Markets - 7.7%	Emerging Markets - 19.9%	Cdn. Bonds - 1.1%	Emerging Markets - 28.2%	Int'l Equities - 16.4%	US Large Cap - 22.7%	US Large Cap 5.3%	US Large Cap 3.3%	US Small Cap 1.3%	Cdn. Bonds 4.1%

Canadian Bonds: Dex Universe Bond Total Return Index
Canadian Large Cap: S&P/TSX Total Return Index
Canadian Small Cap: BMO Nesbitt Burns Cdn Small Cap Index
Emerging Markets: MSCI Emerging Markets Free Index ($Cdn)
Global Equities: MSCI World Index ($Cdn)
Int'l Equities: MSCI EAFE Index ($Cdn)
US Large Cap: S&P 500 Total Return Index ($Cdn)
US Small Cap: Russell 2000 Index ($Cdn)

Source: Globe HySales

[2] MSCI Emerging Markets Free Index ($Cdn)

Why is it so hard to predict the market?

Take hundreds of millions of investors, add in market risks, throw in some herd mentality and a splash of overreaction, and what you get is unpredictability.

Besides the large number of participants in the market, there are also scores of uncertainties that they are trying to measure. At the present time, investors are grappling with the subprime mortgage crisis in the US and its ramifications, the excess global liquidity, heavily indebted consumers in the US, China's overheating stock market, and the huge global trade imbalance.

Because of the numerous possible combinations of future events, it is almost impossible to predict the market. Most individual investors are inexperienced when it comes to the market, and sooner or later, they fall prey to the herd mentality: they buy what everyone else is buying. When herd mentality and overreaction are at work, they can have a powerful effect on market prices, leading to bubbles and crashes.

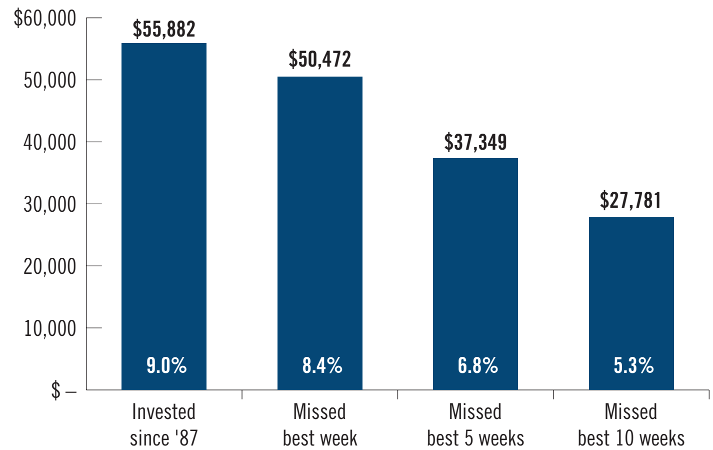
Despite this, many investors still believe they have the ability to forecast the future. The fact is, most investors chase performance rather than anticipate it. Investors also tend to assume that current conditions can continue indefinitely and misjudge how quickly trends can change.

Recall the frenzy surrounding technology stocks in 1999. Many people started investing in tech because everyone else was buying and getting rich. Various market commentators repeatedly warned of a bubble (unfortunately, the market kept climbing, rendering them party poopers).

The crash, when it finally happened, was dramatic in its speed and intensity. Euphoria turned into fear and panic, and finally, capitulation when it didn't look like technology stocks would turn around. Discouraged, many investors abandoned the stock market throughout 2002 and 2003. And of course, 2003 was an excellent year for the Canadian stock market.

Staying invested in the market regardless of market conditions turns out to be one of the best long-term strategies for investors to abide by. There will always be uncertainty in the market and waiting on the sidelines could mean a missed opportunity.

20 Years of the S&P 500
You can't afford to miss the best weeks
Value of $10,000 invested January 1987 to December 2006



Source: Datastream, S&P 500 Price Index, Dec. 31, 2006

Past history has shown that trends can reverse quickly and unpredictably.

From the chart above, you can see that if you had invested $10,000 in the S&P 500 beginning January 1987, you would have made $55,882 by the end of 2006. If you took your money out and missed the best week, the return drops $50,472. If you missed the best 10 weeks – or 1% of the 1,040 weeks over the 20-year period – your return would only be $27,781. Staying invested, even though it means experiencing the losses that stocks often endure, guarantees that you don't miss out on some of the best weeks in the market.

The other antidote to unpredictable market cycles is diversification. By owning a portfolio of different kinds of investments, participating in both styles of investing, and spreading their money around the world, investors can achieve, on average, higher returns and lower risk than any individual investment.

While a diversified approach will occasionally lead to lower returns than the leading category, the downside will also be less severe when the inevitable market and business cycles run their course.

Why should you even bother with equities?

Given the ups and downs of market cycles, along with the financial panics and economic crises, you might wonder whether you should even bother with the stock market. When you look beyond short-term swings, however, you will see that equities offer the best returns of all asset classes.

According to Jeremy Siegel, a professor of finance and author of the investment classic *Stocks for the Long Run* (2002), the long-term real return on stocks after inflation has been between 6.5% and 7% a year. The average annual real return of bonds has been 3.5% – about half of real stock returns. Money market assets have averaged 2.9%.[3]

How does that translate into dollars over a 200-year period? If you had invested $1 in stocks in 1802, that would have grown to $597,485 by the end of 2003. The same dollar would have gotten you $1,072 in bonds and $301 in Treasury bills.

Says Siegel, "The dominance of stocks over other assets is overwhelming. Swings in investor sentiment, as well as political and economic crises, can throw stocks off their long-term path, but the fundamental forces generating economic growth have always enabled equities to regain their footing. Despite our history of depressions, wars, financial panics, and most recently the terrorist attacks and scandals that we faced in 2001 and 2002, the resiliency of stock returns is indisputable."[4]

As an equity investor then, you are entitled to a risk premium because you are a part owner of a business and you are risking your capital. Basically, the equity risk premium is the excess return that investors get over a risk-free rate, which is typically the interest rate on longer-term government bonds. For instance, if the risk-free rate is 5%, and the return on a stock is 13%, then the equity risk premium is 8%. The equity risk premium therefore comes in the form of a higher return.

When investing in equities, most people focus on the potential for capital gains. But another reason why equities are worthwhile is income in the form of dividends. Over time, dividends can be a major contributor the total return. If you had invested $10,000 in the S&P/TSX Total Return Index in 1973, that money would have grown to $321,044 by the end of 2006 – 2.9 times as much as the same amount invested in the S&P/TSX Composite Index (which doesn't include dividends). What's more, capital gains and dividends both provide more favourable tax treatment compared to fixed income in taxable accounts.

Finally, equities provide a hedge against inflation. Over the longer term, equities keep pace with inflation whereas fixed income and money market are hurt by inflation, sometimes resulting in negative returns.

There is no telling where the market will go tomorrow and when trends will change directions. History has shown, however, that over the long term, equities provide you with the best opportunity for investing success.

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[3] Siegel, Jeremy J. *The Future for Investors: Why the Tried and the True Triumph Over the Bold and the New.* New York: Crown Business, 2005, 171.

[4] Ibid, 170.

Summary of lessons

1. Business cycles are a fact of life.
- The four phases of a business cycle are contraction, trough, expansion and peak
- This sequence of events is recurrent but not regular
- We have been through an expansion, so the next major phase is a recession

2. A bear market typically precedes an economic downturn by three to nine months.
- The stock market is one of the best leading indicators of the business cycle
- The US has never had a recession without a bear market preceding it
- If we experience a bear market, it's likely that a recession will follow

3. It is exceedingly difficult to predict when shifts in markets will take place.
- Market trends can change swiftly and dramatically
- Investors tend to assume that current conditions will continue indefinitely
- There are too many catalysts that could tip markets over the edge

4. Diversify!
- Own a portfolio of different kinds of investments
- Participate in both styles of investing – value and growth
- Spread your money around the world

5. Mutual funds provide easy diversification.
- A single purchase in a fund lets you own a large number of securities
- There are numerous ways to diversify: by asset class, region, style, tax-efficiency, and currency
- Diversification reduces the risk in your portfolio

6. In spite of all the cycles and unpredictability, equities are worthwhile.
- Long-term real return on stocks after inflation has been 6.5% to 7% a year
- Compared to bonds and money markets, stocks offer the highest returns
- Stocks give you the best opportunity for investing success

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