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RALLIES DON'T LOOK LIKE RALLIES

By Craig T. Callahan, DBA, Founder and President | March 2, 2010

Because mutual fund statistics and performance are generally public and readily available, financial analysts and other professionals continually study and scrutinize fund managers. At least one conclusion we see time and again in the financial press is that fund managers, for all their expertise, are not good at timing market highs and lows. Stated differently, studies show fund managers are not good at knowing whether they are in a bull market or a bear market. From March 9, 2009 through mid-January 2010, for example, the stock market has been on a spectacular rally, with the S&P 1500 Index rising 72.2%. Throughout this run-up, however, fund managers and other investment professionals have appeared on television interviews and in periodicals predicting a market decline. Many investors have likewise misjudged market direction. They've missed out on this recent rally while they sit in cash and wait for things "to turn around" before they jump back into the market. Generally speaking, we think this is a mistake. Why? Well, while rallies do have some commonalities, rallies don't always look like rallies!

Let's look at a couple of rallies which exhibited the sort of "two-steps-up-one-step-back" feature so unnerving to many investors. In 2003, the S&P 1500 Index gained 42.1% between March 11 and December 31. This growth equated to an impressive annualized pace of 54.1%. The March/December rally covered 205 trading days. Of those days, the market index actually declined 84 days, or 41.0% of the time. Between March 9, 2009 and January 15, 2010, the S&P 1500 Index gained 72.2%. This 2009 rally equated to an annualized pace of 89.6%! There were 217 trading days over this period and the index declined 87 of those days (about 40% of the time – see Table 1 below.)

In both rallies the market declined approximately two days out of every five. Skeptics might initially take comfort in these statistics. Yes, in both 2003 and 2009, the skeptics received confirmation that sitting in cash was prudent approximately 40% of the time. Meanwhile, in the case of the 2009 rally, the skeptics were missing out on a 72% return.

It gets worse for the skeptics on the sidelines. In each of these two rallies, we ranked the days by performance. Hypothetically, what if an investor could be invested only on the very good days? In 2003, the best 18 days of the year compounded produced a return of 43.9%, just slightly exceeding the 42.1% of the entire rally. In other words, just 8.8% of the days produced the entire return in 2003. In 2009, it took the best 16 days to achieve 72.8%, a bit better than the total return from March 9, 2009 through January 15, 2010. During this rally 7.4% of the days produced the entire return. (See Table 2 above.) We've yet to meet the investor, professional or otherwise, who could accurately pick the best days of any given year, but this exercise is instructive nonetheless. Not only did the market go down 40% of the time during these 2003 and 2009 rallies, but only about 8% of the days during these rallies contributed to the positive returns. We believe the bad days in 2003 and 2009 could be considered "noise" that may have spooked some investors from staying invested and participating in the rallies.

A stock market rally is generally not steady and gradual. Rallies are often punctuated by significant declines. In order to participate in a potential rally, however, an investor obviously has to be invested during the interruptions and downturns. Since this rally began last March, we at ICON have steadfastly maintained the position that the stock market was moving higher. In forums as varied as televised CNBC appearances, to presentations before other investment professionals, to our monthly Portfolio Updates and weekly newsletters, we've opined that the fundamentals of value have been and continue to be supportive of higher stock prices. While news events may be disruptive and the rally will likely experience setbacks, we believe the rally in 2009 is the beginning of a recovery that may last a couple of years.

NEGATIVE DAYS TABLE 1 (S&P 1500 Index)	2003 (3/11/03 - 12/31/03)	2009 (3/9/09 - 1/15/10)
Gain	42.1%	72.2%
Annualized	54.1%	89.6%
# of Days	205	217
Negative Days	84	87
% of Negative Days	41.0%	40.1%
BEST DAYS TABLE 2 (S&P 1500 Index)	2003 (3/11/03 - 12/31/03)	2009 (3/9/09 - 1/15/10)
Total Gain	42.1%	72.8%
# of Best Days	18	16
Compounded Return	43.9%	72.2%
% of Best Days	8.8%	7.4%

Past performance does not guarantee future results.

Sources: FactSet Research Systems, Inc. and ICON.



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The unmanaged Standard & Poor's Composite 1500 (S&P 1500) Index is a broad-based capitalization-weighted index comprising 1,500 stocks of large-cap, mid-cap, and small-cap U.S. companies. An individual cannot invest directly in an Index.

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