



of San Diego

HOME

PLANNER RESOURCES

ARE INVESTORS LATE TO THE INVESTMENT PARTY-AGAIN?

Are investors chasing performance-again? Didn't they learn their lesson after the stock market decline the last three years?

Chasing performance-putting the bulk of one's investment funds into today's "hottest" single asset category, sector or security-is like arriving at a party when it's half over. The chips and dips may still be around, but all the big shrimp and the best desserts have been eaten by the earlier arrivals.

Many investors were late to the stock party back in the 1990s, not arriving until 1998 and 1999 and thus missing the big years of 1995-1997, when large cap stocks, represented by the S&P 500 Index, returned 37.5 percent, 23 percent and 33.3 percent, respectively. Returns were still excellent in 1998 and 1999, but the party was over by 2000.

Bonds and real estate may now represent two new parties at which many investors may already be arriving too late.

For example, investors have been fleeing stocks and going into bonds in a kind of mass migration last seen in the late 1990s when investors piled into stocks. During the first nine months of 2002, according to the Investment Company Institute, a net increase (new money over withdrawals) of \$120 billion was invested in bond funds, eclipsing the full-year record of \$103 billion set in 1986.

This isn't surprising. Investors watched intermediate government bonds return 10.5 percent in 2000 while large cap stocks fell 9 percent, and 8.4 percent in 2001 when the S&P dropped 11.9 percent. Through the first nine months of 2002, intermediate government bond funds had returned 7 percent, versus a decline of 24 percent for the S&P 500.

But the last two times investors rushed into bonds, 1993 and 1998, bonds suffered weak returns the following year. The potential problem for investors binging on bonds now is that interest rates are at record lows. The reason bond and bond fund returns have been so good since 1999 is that interest rates have plunged dramatically. Bond prices move in the opposite direction of interest rates. Rates can't get much lower, so the worry among bond experts is that once the economy, and possibly inflation, revs up again, interest rates will rise and bond prices/returns will fall.

Real estate may be at a similar point. For example, after two poor years in 1998 and 1999, real estate investment trusts (REITs), which invest in everything from shopping malls to mortgages, returned 26 percent in 2000 and 15.5 percent in 2001. When investors finally realized how well REITs were performing, they began putting money into REITs in much big numbers in 2002-just in time to see REIT returns slip to slightly over four percent the first three quarters of 2002. Investment pros reportedly are

already moving out of real estate and back into battered stocks.

In short, have many investors already missed the best part of the parties for bonds and real estate? Has the bulk of the good returns already occurred?

Evidence suggests that during a market recovery the best of the returns tend to occur early. That is certainly the case with stocks, according to a study by SEI Investments, an asset management firm in Oaks, Pennsylvania. SEI studied 12 bear markets since World War II. Investors who either stayed in the market through its bottom, or were fortunate to enter at the bottom, saw the S&P 500 gain an average of 32.5 percent (minus dividends) that first year. Investors who missed only the first week of the recovery saw gains that first year slide to 24.3 percent. Those who waited three months before joining the party gained only 14.8 percent.

Of course, there is no way to predict exactly when the bottom will occur or what sector will become the next hot one. And it is not to say that one shouldn't be invested now in real estate or bonds. That's why financial planners counsel that investors don't forsake one asset class in favor of another one, but instead diversify among asset classes. Studies show that a good mix of asset categories usually provides superior and more stable returns over the long haul than trying to time the market by heavily over-weighting in a single category.

It beats being late to the party.

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