RAPPAPORT REICHES
CAPITAL MANAGEMENT, LLC

JANUARY 2014

Journal of Value Added Indexing℠

A Look Back at 2013: A Welcome Surprise

The unusually strong performance of US stocks in 2013 was a welcome surprise for investors who follow a straightforward buy-and-hold strategy and a source of exasperation for many professionals caught flatfooted by the steady rise in share prices. It was the best year for the S&P 500 Index since 1997, with a total return in excess of 32%. International stock markets also did well, with the MSCI World ex USA Index posting a total return of 21%.

To some experts, it wasn't supposed to look like this. A *Barron's* cover story appearing in November 2012 warned investors to "get ready for the recession of 2013." The title of a *Time* article on the outlook for financial markets that same month shouted, "Why Stocks Are Dead" in oversize type. A prominent economic forecaster who predicted the downturn in 2008 suggested that four elements—stagnating US economic growth, the European debt crisis, a slump in emerging markets, and military conflict in the Middle East—could combine and lead to a "superstorm."

Another prognosticator—and longtime *Forbes* columnist—ticked off a long list of worries, including a new wave of housing foreclosures, persistent government deficits, weak consumer spending, high unemployment, and unsustainable corporate profit margins. His prediction for 2013: "the S&P 500 Index drops to 800, a 42% decline." Others fretted about a deepening slump in China that could drag the rest of the world down with it.

Detroit's bankruptcy filing in July—the largest American city to do so—and the acrimonious debate over public finances in many cities and states suggested to some that a tectonic shift in municipal finance was underway with worrisome consequences. One prominent Wall Street researcher observed that "the aftershocks of the largest municipal bankruptcy in US history will be staggering, and Detroit will set important precedents."

Individual and professional investors alike braced themselves throughout the year for a sharp selloff that never materialized. At times, the perverse reaction to rising prices was not delight but apprehension of an even steeper decline to come. On March 5, 2013, for example, the Dow Jones Industrial Average finally eclipsed its previous record of 14164.53, set in October

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The Headlines predicted…

January 12	“Rebirth of Equities Ain’t Necessarily So,” *Financial Times*
February 8	“Scant Pickup in Economic Growth Seen for 2013,” *Wall Street Journal*
March 7	“Stock Markets Defy Economic Woes,” *Financial Times*
April 2	“Lesser Expectations: Earnings Hopes Dim for First Quarter,” *USA Today*
May 18	“Stock Market Optimism on This Scale Hard to Explain,” *Financial Times*
July 7	“As Investors Rush in, Stocks Are Sending Warning Signals,” *Wall Street Journal*
August 24	“Lofty Profit Margins Hint at Pain to Come for U.S. Shares,” *Wall Street Journal*
September 18	“Profits Boost Needed for Wall Street’s Equities Run,” Michael Mackenzie, *Financial Times*
October 7	“Get Ready For a Drop in Stock Prices,” *Wall Street Journal*
November 16	“Is This a Bubble?, *Wall Street Journal*

The Real News:

2013 Returns:[1] **US Stocks +32%, International Stocks +21%**

2007. But the *Financial Times* reported that the prevailing mood among veteran New York Stock Exchange floor traders was “more anxious than joyful.”

Month after month, a chorus of financial journalists recycled the same arguments we have heard regularly for the past several years: Economic growth is well below average, stocks are expensive relative to earnings, corporate profit margins are historically high and can only come down, earnings growth is too weak, asset prices have been artificially inflated by an expansive monetary policy, and so on.

What can investors learn from this year’s market behavior? As the baseball player Yogi Berra said, “It’s tough to make predictions, especially about the future.” Guessing how other investors will respond to unpredictable events is harder still. But, for many, the temptation to engage in such efforts by timing the markets is irresistible.

Results from this past year tell us we should be skeptical of anyone’s ability to outperform a long-term disciplined strategy. Investors are well served by following a thoughtful plan, broadly diversifying among many areas of the markets, rebalancing when appropriate, and keeping costs low.

When investors are studying the long-run record of stock market returns several years from now, we suspect many of them will find it difficult to recall exactly what it was that discouraged them from achieving the capital market rewards that were there for the taking.

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Sources

1. US Stocks: S&P 500 Index,
   International Stocks: MSCI All World ex US index (net div)

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A. Gary Shilling, "Prepare for a Market Plunge," *Forbes*, January 21, 2013.

Meredith Whitney, "Detroit May Start a Wave of Municipal Bankruptcies," *Financial Times*, July 24, 2013.

Adam Davidson, "What's it Going to Be, 2013?," *New York Times*, January 6, 2013.

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