Responding Correctly to a Financial Crisis Can Change Your Life

Following your gut was not a good idea in the wake of the 2008 financial crisis.

By PAUL PRICE • Oct 06, 2018 | 02:00 PM EDT

More than 10 years have passed since the Lehman bankruptcy sent America, and the world into financial crisis. Periods like that are true tests of investors' ability to weather major storms.

The visceral response is always "a flight to safety." Holding cash, or ultra-safe government securities, always seems prudent and can guarantee no further losses compared with remaining in equities.

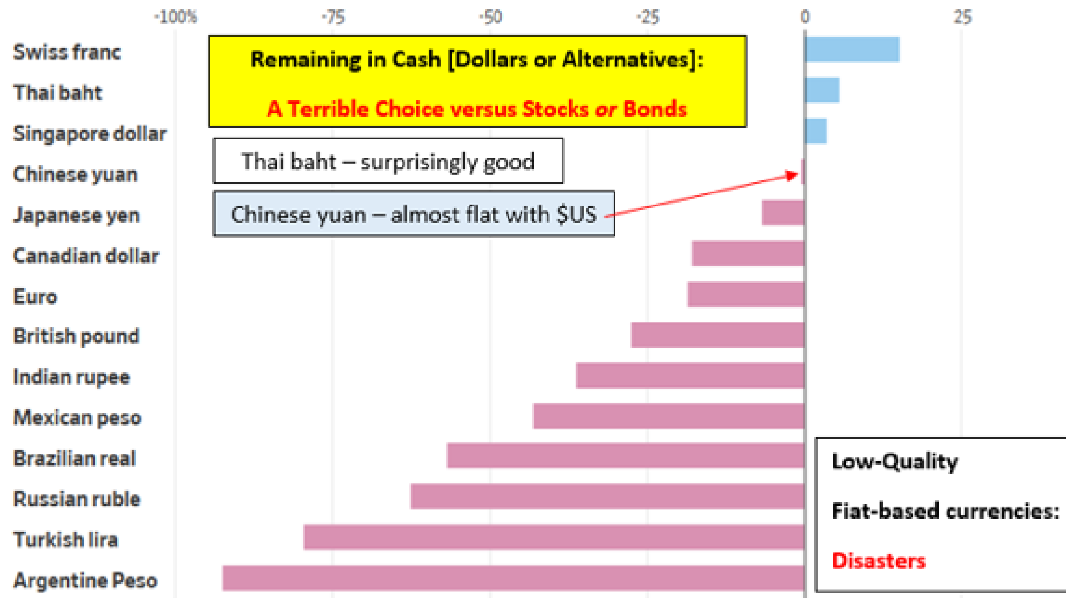
Actual results, though, from Sept. 15, 2008 through Sept. 14, 2018, showed that following your gut proved to be completely wrong.

Converting to cash, whether in dollars, pounds, yen or other currencies, and sitting out the turmoil for the next ten years, insured that you never recovered the losses which had already taken place.

That choice, moreover, underperformed both stocks and bonds in the decade that followed.

Highly thought of currencies like the Swiss Franc and Singapore dollar fared better than America's own dollar. Somewhat surprisingly, the Thai baht did, also.

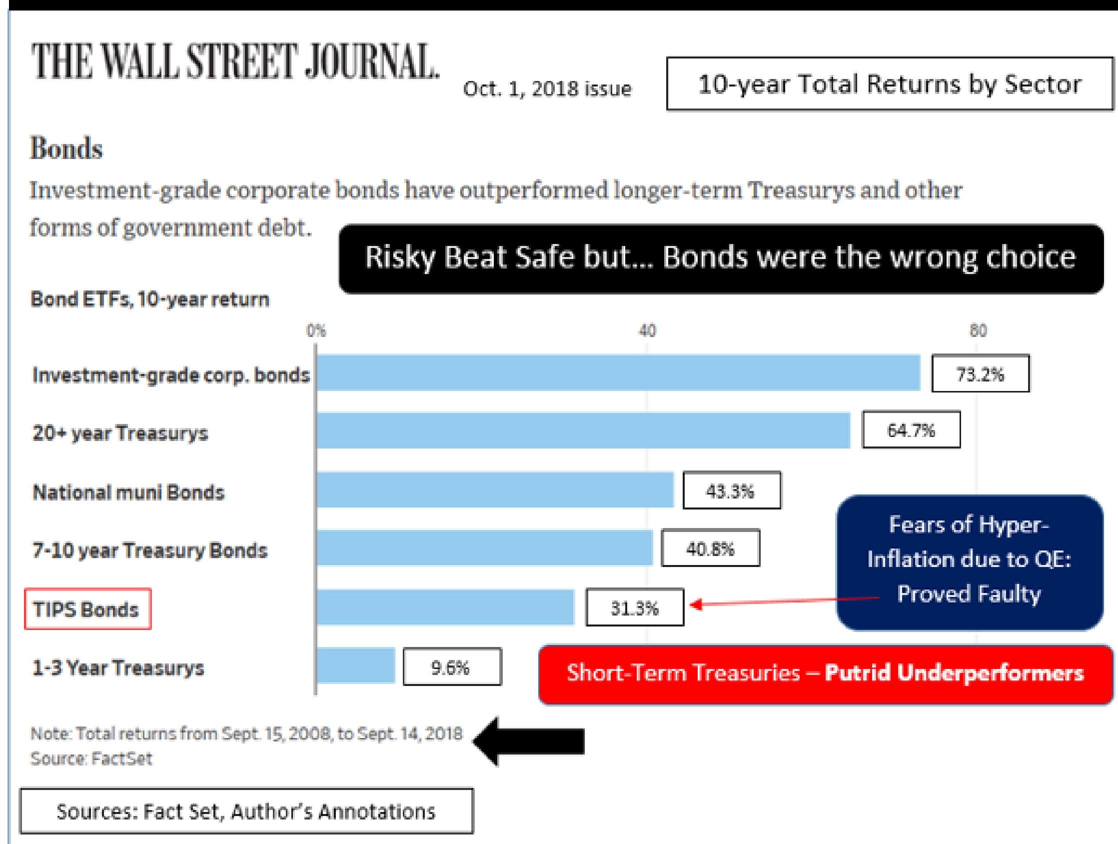
Despite all the political hype surrounding manipulation of the Chinese yuan, that unit remained remarkably flat with the dollar over the full decade ended Sept. 14, 2018.



Low-rated fiat-based paper money took a serious chunk out of investors' net worths, even before figuring in the devastating effects of inflation. Even the best-returning currency, the Swiss franc, failed to hold its buying power over the decade which unfolded [TIPS bonds, here in the U.S., returned 31.3%] over the next decade.

Switching from stocks to bonds was another popular strategy for dealing with 2008's crisis. Traders who followed that path found riskier paper did better than safer government-issued bonds.

Corporate issues and long-term securities ended up far outperforming ultra-safe 1 - 3 year maturity Treasury issues.



Initial belief that QE programs (massive money printing) would immediately trigger hyper-inflation proved to be incorrect. Normal citizens were loath to spend freely with little faith in their job security or the fate of our economy. The QE money propped up major banks without ever finding its way to mom and pop's pockets.

What was the proper way to play the crisis? *Damage already suffered could no longer be avoided. You needed to look forward, not backward.*

Somewhat ironically, the riskiest path was by far the best, even though it would have seemed foolhardy at the time. From Sept. 15, 2008 through Sept. 14, 2018, tech stocks, as represented by the Nasdaq Composite, gained more than 311%. The DJIA tacked on 211.5% while the S&P 500's total return ran 201.9%.

Note on the chart below that intrepid investors needed the fortitude to endure significant short-term losses from that mid-Sept. 2008, period through March 9, 2009, before seeing a sustained recovery.

It's not easy holding onto your conviction in the face of 50% further drawdowns.

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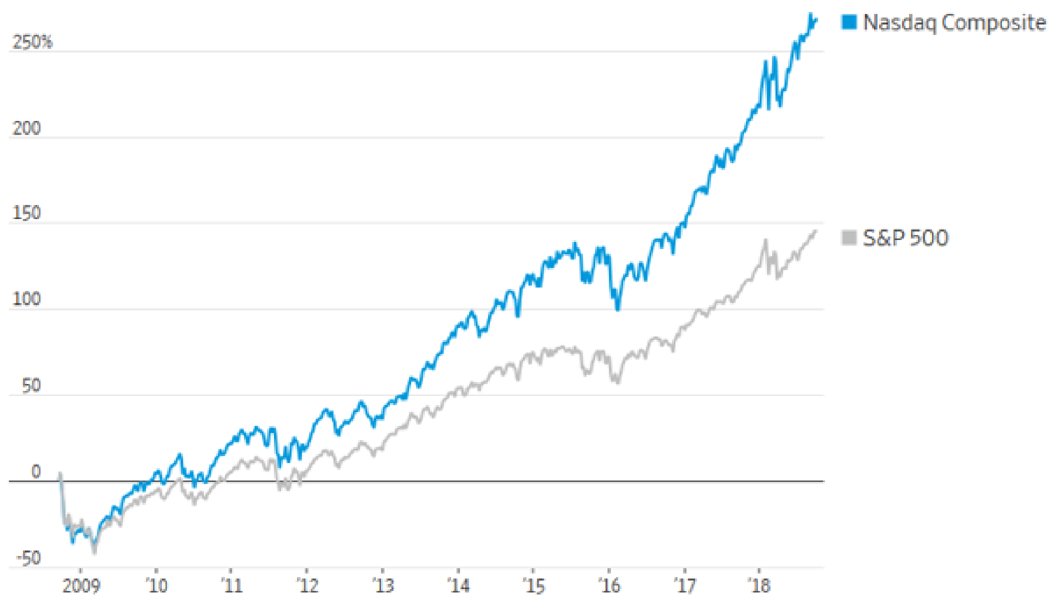
MARKETS

The Best and Worst of Crisis-Mode Investing, 10 Years Later

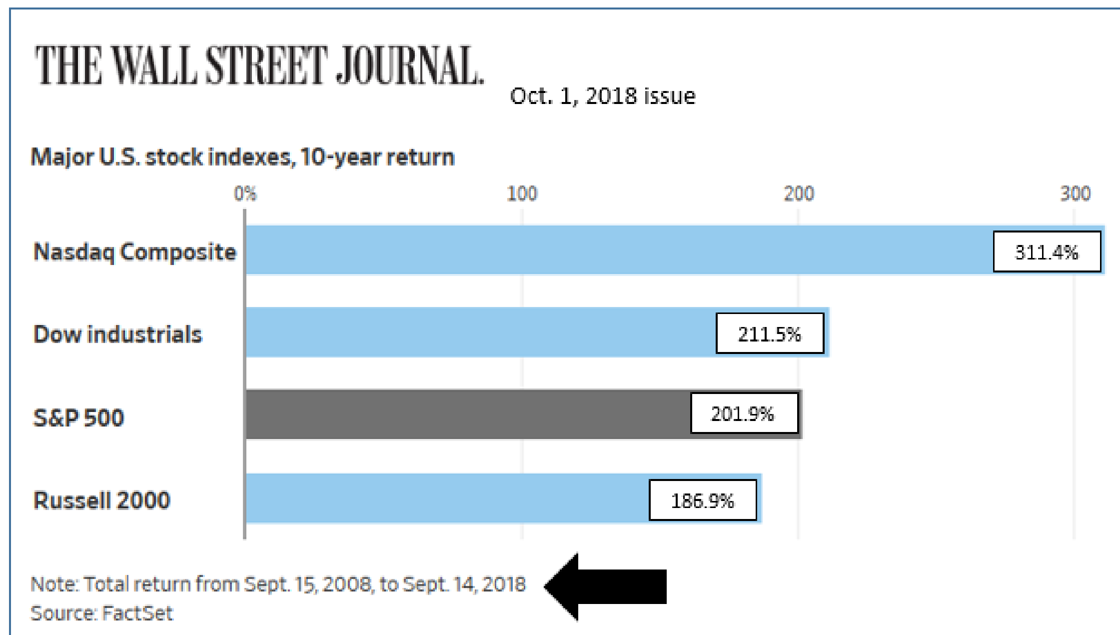
Index performance since Sept. 15, 2008



Note: Weekly data
Source: Dow Jones Market Data

Unlike what happened in the bond markets, equity performance was a mixed bag. Tech beat out the large-cap indices but going riskier, into small-cap Russell-2000 shares, paid off a bit less than sticking with higher quality.

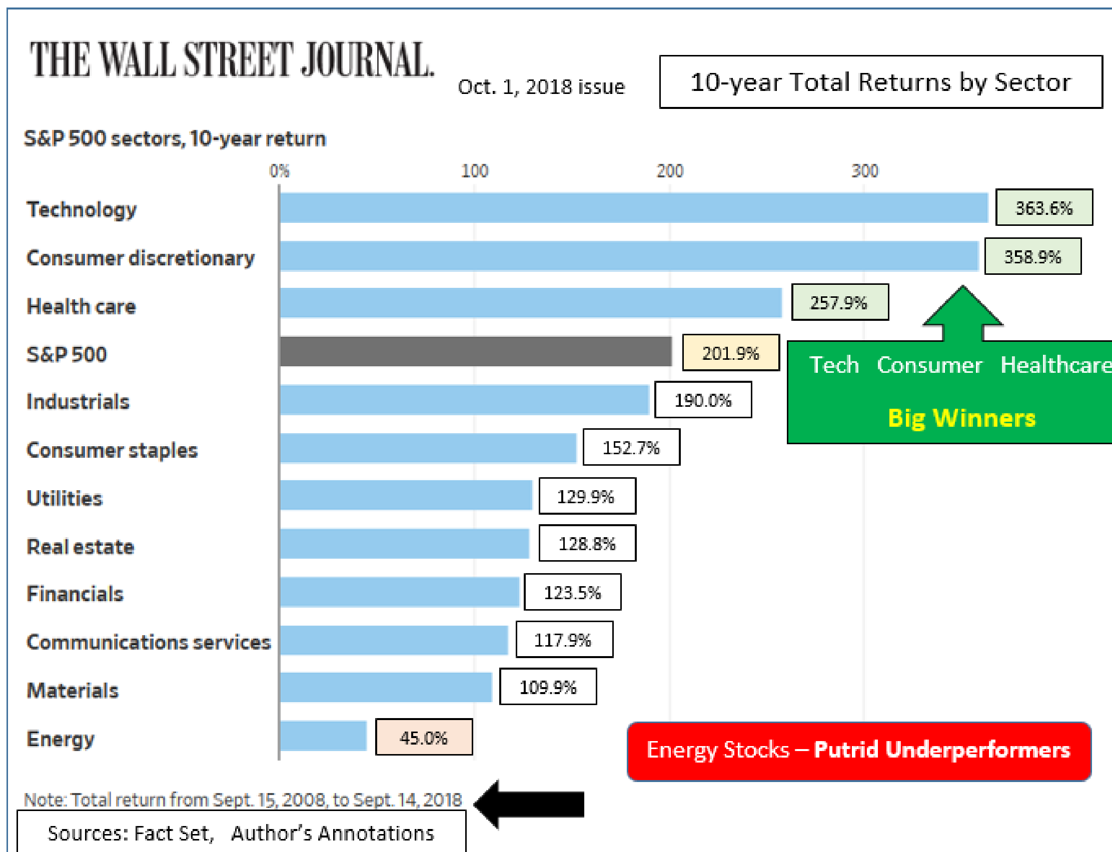
Even so, 186.9% on the Russell 2000 was far better than holding cash or any category of bonds.



Breaking down the broad market showed three clear winners over the most recent 10 years. Tech, consumer discretionary and healthcare were the only industry groups to beat the S&P 500.

Traditional safe-haven defensive segments like utilities and real estate did much better than bonds but worse than most, more aggressive industries.

Going big into energy proved to be the only way to play stocks while still underperforming bonds.



What are the major takeaways from all this data?

- By the time you feel panicky, it's probably too late to get out.
- Fighting your emotions is necessary if you expect to make up losses and go on to new heights.
- Nobody is smart enough to "call the bottom." You must be prepared to weather further, temporary, losses on the way to recovery.
- Groups that were beaten up the most on the way down often lead the pack when the inevitable rebound kicks in.
- Avoiding risk is a sure way to keep from being well-positioned.
- Waiting for "good news" before getting back into equities is ill advised.
- Managed correctly, severe bear markets can actually make you money.
- **Every major market selloff in the history of the U.S. has been temporary.**

My own net worth is way, way higher than it was early in 2008, before that year's extreme damage took place. I was able to accomplish that feat by ignoring market timing and staying fully invested throughout the years.

In the end, stocks almost always revert to their proper prices, based on fundamentals. Stick with that principal, have patience and success will follow.

This commentary originally appeared on Real Money Pro on Oct. 3. ***Click here*** *to learn about this dynamic market information service for active traders.*

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At the time of publication, Price owned no bank CDs, bonds or other fixed-income vehicles. He remains heavy in stocks. He owns no index funds or ETFs.

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