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Welcome Back To 10,000 ... Sort Of

"Tonight we're going to party like it's 1999."
- Prince

There was much celebrating on Oct. 14, when the Dow Jones Industrial Average closed above 10,000. It was the first time the Dow reached that mark since October 2008 and it marked great progress from the 6,547 close on March 9, 2009.

Still, as Dorsey Wright & Associates wrote in an analysis, it's sobering to recognize that the Dow is right where it was 10 years ago. That's more than 2,500 days of market openings and closings with a net result of zero growth.

Given the events of the past couple of years, it's no wonder we're celebrating! But this is one parade that merits some steady rain, if not a downright downpour.

First, consider why the Dow has rallied. When the market collapsed, there was so much money sitting in cash, it stimulated the market.

How? If your money were fully invested in the market, there would be no potential for new net demand, unless you bought on margin. If you were completely in cash, all of that money would represent new potential demand for equities.

When too much money is on the sidelines, a bottom is reached and demand sends stocks back up. Once the markets start to recover, "momentum investing" takes over. Hence, the 53% increase in value for the Dow.

However, as *Daily Finance* put it, "Breaking the key psychological level of Dow 10,000 is one thing. Holding onto those gains is quite another."

Without strong fundamentals, the five-digit Dow is unlikely to last long.

No Recovery For Most Investors

Two factors make reaching the 10,000 milestone for the Dow what Dorsey Wright calls "the quintessential Pyrrhic victory" for many investors around the world.

First, bond funds attracted net deposits of $209.1 billion in the first eight months of 2009, while stock funds drew just $15.2 billion. For every new dollar moving into equities, $14 was moving into bonds.

This shows that investors who lost money in the collapse of 2008 were moving what was left to the perceived safety of bonds, just as the market bottom materialized. This is not unusual.

Second, according to Dorsey Wright, the continued decline of the U.S. dollar has meant that foreign investors in U.S. markets have not been made whole. Far from it. They gained more dollars as the market recovered, but each dollar is worth significantly less.

In terms of the Euro, the Dow would need to rally an additional 45% to return to its October 1999 levels ... and that's assuming no further decline in the U.S. dollar. The Dow would have to recover 46% for Australian and Canadian investors to recover. At least when priced in the yen, the Dow is within less than 20% of its 1999 levels.

Some believe the current rally is a "fool's rally," which is not grounded in solid market fundamentals. If that's true, it may be a long time yet before most investors' portfolios return to the level they were at in 1999.

Comparing the 1982 Bull Market with the 2009 Rally

Rally Comparison	1982	2009
P/E Multiple	8X	26X
Dividend Yields	6%	below 2%
Book Value	Discount to Book	2X Premium
Monetary Policy	Reducing money growth and inflation rates	Creating money growth and inflation rates
Fiscal Policy	Aimed at reducing nondefense spending	Aimed at accelerating nondefense spending
Deficits	Peaking and coming down relative to GDP	Surging to 10%+ relative to GDP
Global Trade Barriers	Were being torn down	Are being erected
Regulation	Deregulation in vogue	Re-regulation rising
US Dollar	Plaza Accord bull market	Mercantilist bear market
Household Credit	Balance sheets and participation rates expanding	Balance sheets now contracting
Tax rates	Income, capital gains and dividend taxes declining	Taxes Rising Now

Sources: Gluskin Sheff, S&P, Bloomberg

How does the current market rally compare with the 1982 bull market? Barry Ritholtz gave the comparison above on his blog, The Big Picture.

When Is Active Management Not Active Management?

Most mutual funds give the term "active management" a bad rap.

Mention the term "active management" to most investors and they will immediately think of mutual funds. After all, mutual funds have been marketed to the public as offering the advantage of active management.

Of course, when we say "bad rap," we should note that not every mutual fund is Vanilla Ice bad, but most are outperformed by their benchmark index. Some mutual funds are, indeed, managed by very good and fairly active money managers.

But is the typical mutual fund manager an "active investment manager," as we would define the term?

Well, no. And I would argue that that's why the typical index fund outperforms the typical "actively managed" mutual fund.

Mutual fund managers are bound by the fund's investment statement to invest in a certain manner. The manager of a municipal bond fund invests virtually all of the fund's assets into municipal bonds. The manager of a small-cap growth fund invests virtually all of the fund's assets into small-cap growth stocks. And so forth ... whether it makes sense to invest that way or not, based on what's happening in the market and the economy as a whole.

True active managers pay close attention to both fundamental and technical analysis, and adjust their investments based on market trends and overall expectations. That's why, for example, most of us were advising clients to sell off their stocks in the summer of 2008, while mutual fund managers were holding steady.

Dave Lucca, CFP of Rhoads Lucca, in an article entitled, "Who's Protecting the Money in Mutual Funds?" wrote that, "Mutual fund managers don't have the responsibility (by prospectus) of guarding you from severe declines or bear markets - only for investing the money into stocks and/or bonds according to the investment philosophy of the fund."

Mutual fund managers don't see a need to protect your money, because they believe that if you invest your money long-term (i.e., "buy and hold") eventually you will make a profit.

Of course, if a bear market hits and you lose 50% of the value of your investments, you will have to buy and hold ... and hold ... and hold. If you're approaching retirement, you may not live that long.

Lucca points out that this approach is in line with "the Efficient Frontier/Market Hypothesis/Portfolio Optimization methods of optimizing asset allocations over great periods."

Portfolio theory makes fascinating reading, but it doesn't always make investors money.

What About Index Funds?

You could save the management fee you pay when you invest in a mutual fund by investing in an index fund, which is not actively managed.

However, as Lucca points out, a great deal of money has been invested in index funds over the past five years, driving the prices of the largest stocks in those funds artificially higher.

"This has increased the amount of risk associated with these funds," according to Lucca. "In a bear market you will be 100% invested in declining stocks."

In the News

In recent months, Wenning Investments has been featured in *The Wall*

Street Journal, *Forbes*, *Fund Strategy* and *The MetroWest Daily News*. Be sure to visit our newsroom for the latest updates.

Keep in Touch

Have an idea for a future issue of *Wenning Advice*? Are you interested in active investing or would you like to refer a friend who may be interested?

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