[the*compass*] fall 2011

THIS ISSUE...

Déjà Vu All Over Again

by Dan Tolomay, CFA

Yogi Berra's famous line is an appropriate description of recent market conditions. From April 29th to August 8th, the Standard and Poor's 500 index fell 17.9%. This decline, beyond a "correction" (-10%) but not quite a "bear market" (-20%), seems exceptional. Yet, if we look back, we see that market declines in excess of 15% have occurred eleven times in the last 55 years – or, roughly, once every five years.

The peak-to-trough moves of the market have varied in both time and magnitude. The S&P swiftly fell 19.3% in 1.5 months (July 1998-August 1998) in what was also the smallest such decline. But, the index also drifted lower -- 49.1% for 30.5 months (March 2000-October 2002). The largest drop, which remains fresh in our memories, was 56.8% (October 2007-March 2009).

The duration of recoveries has been mixed, too. The market has recovered all of its losses in as quickly as 2.8 months (August 1998-November 1998). But, it took 69.5 months (October 1974-July 1980) to recoup its losses from January 1973 to October 1974.

NOTABLE QUOTE

"We cannot absolutely prove that those are in error who tell us society has reached a turning point, that we have seen our best days. But so said all before us, and with just as much apparent reason. On what principle is it that, when we see nothing but improvement behind us, we are to expect nothing but deterioration before us?"

– Thomas Macaulay (1830)

Decline	Old Peak		Trough		Decline		New Peak		Recovery	
Peak-to-Peak	Date	Index	Date	Index	Months	Return	Date	Index	Months	Return
Aug 56 - Sep 58	8/2/1956	49.64	10/22/1957	38.98	14.7	-21.5%	9/24/1958	49.78	11.1	27.7%
Dec 61 - Sep 63	12/12/1961	72.64	6/26/1962	52.32	6.4	-28.0%	9/5/1963	73.00	14.3	39.5%
Feb 66 - May 67	2/9/1966	94.06	10/7/1966	73.20	7.9	-22.2%	5/4/1967	94.32	6.9	28.9%
Nov 68 - Mar 72	11/29/1968	108.37	5/26/1970	69.29	17.8	-36.1%	3/6/1972	108.77	21.4	57.0%
Jan 73 - Jul 80	1/11/1973	120.24	10/3/1974	62.28	20.7	-48.2%	7/17/1980	121.44	69.5	95.0%
Nov 80 - Nov 82	11/28/1980	140.52	8/12/1982	102.42	20.4	-27.1%	11/3/1982	142.87	2.7	39.5%
Aug 87 - Jul 89	8/25/1987	336.77	12/4/1987	223.92	3.3	-33.5%	7/26/1989	338.05	19.7	51.0%
Jul 90 - Feb 91	7/16/1990	368.95	10/11/1990	295.46	2.9	-19.9%	2/13/1991	369.02	4.1	24.9%
Jul 98 - Nov 98	7/17/1998	1,186.75	8/31/1998	957.28	1.5	-19.3%	11/23/1998	1,188.21	2.8	24.1%
Mar 00 - May 07	3/24/2000	1,527.46	10/9/2002	776.76	30.5	-49.1%	5/30/2007	1,530.23	55.7	97.0%
Average					**12.6**	**-30.5%**			**20.8**	**48.5%**
Oct 07 - ??? ??	10/9/2007	1,565.15	3/9/2009	676.53	17.0	-56.8%	8/8/2011	1,119.46	29.0	65.5%

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The Other Side of the Trade

by Mike Palmer, CFP®

The market volatility we experienced in early August provided an interesting insight into investor behavior. Some investors feared a repeat of 2008 and made a stampede for the exits. Over the course of six days (between August 1 and August 8) the S&P 500 fell 13.5 %. But as is too often the case, those selling stocks during times of market scares rarely think about the other side of the trade. For in order to sell stock, there has to be someone willing to buy, and rarely do investors think about the motivation of the person on the other side of the trade.

We've long opined on our belief that investor *behavior* is of far greater importance than investment *selection* or *timing* in producing a successful investment experience. We can cite any number of statistics and studies to support this contention. But as with many things in life, there is a meaningful difference between talking hypothetically about market downturns and reacting rationally in the midst of them.

While it is a natural impulse to want to take action, any action, when stock prices are falling, we'd offer yet another mechanism to help provide restraint. Take a moment and think about the other side of the trade. Who is it that is buying your stock? If the answer is perhaps Warren Buffett, then maybe it might make sense to reassess and consider what side of the trade you want to be on – the smart money or the dumb money?

To that end Warren Buffett was interviewed by Charlie Rose in mid-August and when asked about the market turmoil of early August Buffett replied, "Last Monday (August 8) we (Berkshire Hathaway) spent more money buying stocks than any day this year." My guess is this was a classic wealth transfer – smart money taking long-term profits at the expense of dumb money.

While there's no way to know precisely who is buying your stock, knowing that someone as smart and successful as Buffett is buying should be evidence enough that perhaps selling at such a time might not be the wisest course of action.

The Shrewdest Investment Ever

by Mike Palmer, CFP®

North Carolina has an interesting link to what might be the shrewdest investment ever made. From 1969-1974 the Carolina Cougars were a team in the upstart American Basketball Association (ABA). Trying to compete with collegiate basketball in our market proved to be difficult and following the 1973-74 season the Cougars franchise was sold and moved to St. Louis.

In 1976 the NBA and ABA merged, but only four of the remaining six ABA teams found a home in the NBA. The Kentucky Colonels accepted a $3.3 million buyout and folded. But the story of the remaining ABA team, the Spirits of St. Louis, would become the stuff of legend.

The St. Louis ownership group (which had purchased the franchise in 1974 for $1.5 million) negotiated a deal that has been described as the "greatest deal known to man."

The St. Louis owners, brothers Ozzie and Dan Silna, agreed to a buyout of their team for $3 million plus 1/7th of the four surviving ABA teams' NBA television contract revenue…in perpetuity!

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Peeling the Onion

by Jay Eich, CFP®

How will you divide your estate? What lessons did you learn from your parents about money? Do those messages affect you today? Discuss a positive and negative experience you have had with prior firms you have worked with. Do you perceive "retirement" as a positive or negative word? How much life insurance do you have and why? Discuss some of your best and worst financial decisions. Do you agree with the financial decisions your spouse makes? What are you passionate about? How do you want to be remembered? What kind of role do you want to play in your grandchild's future? What scares you? What do your friends love about you? Some of these questions are easily answered, but others require a great deal more thought. These are the questions we ask our clients.

What makes these questions difficult to answer? Some are difficult because they force us to make tough choices. Should we split our estate evenly between our two children, or leave the bulk to the child who is not financially secure?

Other questions are tough because they touch on our deepest fears. If you grew up lacking financial resources, you may be reluctant to spend or gift out of a fear of returning to that state. Alternatively, if you grew up with abundant wealth, you may feel anxious about losing that financial status, having never lived with less. Certain questions bring scrutiny to marital relationships, family dynamics or friendships thereby generating discomfort and anxiety. Many of these questions require us to face uncomfortable truths about ourselves and our loved ones. Thoughtful, truthful responses, however, are essential in order to craft a financial plan that will provide peace of mind to the client and security for his or her loved ones. That is why we ask; the more effectively we understand our clients, the better we can serve them.

Competent financial planners must be technically proficient across all planning disciplines – cash flow, estate, risk management, investment, tax, charitable gifting, and education. Truly effective planners, those who take the time to ask tough questions and listen carefully to the responses, provide much more. Only by understanding your goals and dreams can we help you achieve them.

Interested in learning more about behavioral finance?

Tuesday, October 11 at 10:30 am

3600 Glenwood Avenue, Suite 210, Raleigh, 27612

Join Trust Company's Mike Palmer for an hour long session exploring how behavioral biases harm investors and techniques you can use to avoid them. Seating is limited, so please call Lisa Shirley (919) 781-8287 or email her at lshirley@tcts.com to reserve your space.

Behind the Scenes at Trust Company of the South

>> **Mike Palmer** was quoted in the August 5th edition of the *New York Times* in a story on investors' apprehension of international investing.

>> **Will McPherson** served as sponsor services leadman for the Wyndham Championship.

>> **Mike Palmer** recently attended the DFA Advanced Conference in Austin, TX and was named chair of the DFA Large Firm study group.

Déjà Vu, continued from cover

While these statistics help to put the recent decline in perspective, they also show the difficulty in determining when or how the market may turn. These uncertainties (a.k.a. risks) are why equities have historically provided a higher return than bonds or cash.

What is certain is that to participate in the recovery, you have to stay the course. It is impossible to "time" the market – i.e., jumping in when returns are good and jumping out when returns are bad. To earn the higher returns of the stock market you must bear the higher risks.

Shrewd, continued from cover

Based on the most recent NBA television contract, that worked out to a payment of $17 million just last season. It is estimated that the Silnas have reaped $240 million over the last 35 years (a cumulative return of over 15,000%!) with future payouts likely to increase for decades to come. "I think nearly every single attorney and sports executive has taken a look at the deal to see if they can break it, and I've yet to talk to anybody who says it can be broken," said former Denver Nugget executive Gary Hunter.

When the deal was consummated the NBA television contract was a mere pittance, a little more than $10 million per year divided among 22 teams. "The first few years our check was like $200,000. The process never even entered our minds of how high it would get," said Ozzie Silna, "we just wanted a piece of the action."

THE TRUST COMPANY OF THE SOUTH

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