

ASPERA BULLETIN

Intelligent, Independent Investment Management

Anatomy Of A Secular Bear Market

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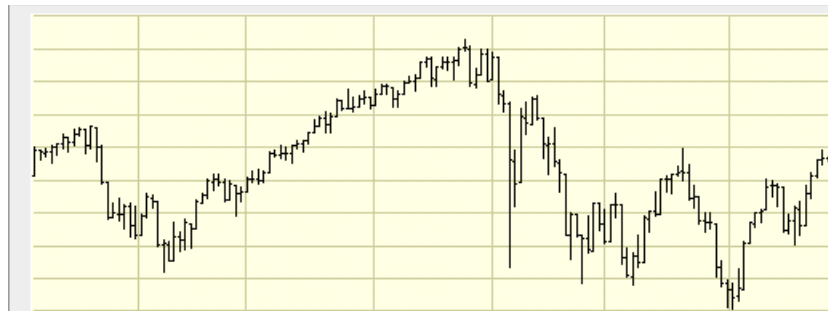
Aspera offers independent fee-only investment management and advisory services throughout the Triangle area and nationwide.

Every client portfolio is separately managed.

The securities and strategies discussed in this Bulletin may not apply to every client portfolio.

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Look at the two charts below. Each shows the Dow Jones Industrial Average but over different time frames. What do you see? No, this isn't a Rorschach test. If you immediately see armored butterflies dueling with kielbasa then you're missing the point of this (and should seek professional help). Don't these two charts look awfully similar?



The first chart shows the performance of the Dow for the 2010 year-to-date period. The second chart shows the performance of the Dow over the last 10 years. Both show large moves up and down with absolutely no net progress being made. It's merely an interesting coincidence that these two charts look so similar. The more relevant point is that the price action in both charts is typical of secular bear markets. Panic-laced declines are followed by euphoria-inducing rallies which are followed by depressing collapses which precede hopeful climbs...and so on. These secular bear markets last for many years and tend to finally come to an end once the masses have finally sworn off equities (literally and figuratively) and when the market is selling for less than 10 times earnings.

Unfortunately, the cult of equities still has a healthy heartbeat, and valuation is far from the levels reached at the beginning of long-term bull markets (or the end of long-term bear markets). In fact, if you were to ignore the bubble valuations that we experienced from the late 1990s through 2007, you'd find that the market is currently at the high end of its historic valuation range. Too many people, however, are still making the mistake of viewing this 10-year period as normal despite a massive credit explosion and tremendous distortions caused by ill-advised monetary and fiscal policy. My younger readers or those with a predilection for cryonics will look back at this period with disgust and incredulity.

A secular bear market doesn't go straight down. It's a process. Whatever the path, we're still leaning into a stiff investment headwind and likely will be for a number of years. Secular bear markets wear investors down, and they take time partly because each of us has a different tolerance for pain. There is a very strong possibility that investors will eventually abandon stocks as they have at various times in the past. Some will be forced to sell because of job losses. Some will sell to fund their retirement. Some (not you) will sell after being burned by an investment adviser. Many, however, will gradually grow frustrated with the grinding action of this bear market and eventually capitulate. At some point, this cumulative selling should take the market back to historically attractive valuation levels.

The U.S. stock market and economy today remind me of the water heater that I recently replaced. The water heater had a pin-sized hole in its rusted bottom. I had the choice to either pony up and buy a new water heater immediately, or I could ignore it. If I ignored it, the tank would gradually erode, and the size of the hole would slowly expand. I could slap on layer after layer of duct tape, but at some point the tank would cease to hold any water at all as the water entering through the top would immediately empty from the bottom. On a positive note, my property would have a new -- albeit expensive -- water feature. When it comes to the economy and markets, our leaders have chosen the duct tape option, masking the symptoms while ignoring the rot. The duct tape is still being applied, but it won't hold indefinitely. The economy and the markets need a new water heater.

Despite my current risk aversion and questionable analogies, we're not simply sitting on our hands. We are extremely focused on risk management in this environment, but we're also still able to find interesting opportunities. Though I may not be constructive on the general equity market, the market is made up of thousands of firms and dozens of industries, some of which I'm quite bullish on. More importantly, however, we're not constrained to the long side nor are we limited to stocks or the U.S. market.

A final note: On the following page you'll find a nice example of a long-term secular bear market. Some of you may recognize it as the Nikkei. Keep this chart in mind whenever you hear some talking head on television jabbering on about the wonderful outlook for U.S. equities.

Best,

Ken Bell, CFA, CFP

President
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The Private Thoughts of a Typical Investor

