

DOWN TO THE WIRE

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Another Wall of Worry

Investors have been confronted with a steady drumbeat of discouraging news over the past year, but we suspect that many would be surprised to learn how well stock prices have done.

Stock prices rallied sharply around the world in the third quarter, with 42 out of 45 countries tracked by MSCI showing positive returns in US dollar terms. Total return exceeded 10% in 19 different markets, while Ireland, Japan, and Morocco registered minor losses.

For the twelve-month period ending September 30, 2012, 40 markets had positive returns, with six countries—including the US—delivering a total return in excess of 30%, according to MSCI.

Investors have been confronted with a steady drumbeat of discouraging news over the past year—a feeble economic recovery here and abroad, staggering budget deficits with no solution in sight, the prospect of a Eurozone breakup, an acrimonious

presidential election campaign, banking scandals, and a punishing drought across the US. Considering all the uncertainty, it's not difficult to explain why mutual fund investors have generally favored fixed income strategies rather than equities over this past twelve-month period.

Many investors are easily persuaded that successful investing requires constant attention to current events and frequent adjustment of their equity exposure. The news excerpts below represent just a small sample of the issues investors might have dwelled on. We suspect that many investors not only failed to achieve their respective market rate of return over the past twelve months but would be surprised to learn how well stock prices have done in many markets over that period.

“Unless politicians act more boldly, the world economy will keep heading toward a black hole... At a time of enormous problems, the politicians seem Lilliputian. That’s the real reason to be afraid.”

“The World Economy: Be Afraid,”
Economist, October 1, 2011.

“Investors also are nervous because October historically has been one of the more volatile months for stocks.”

E.S. Browning. “Market Nears Bear Territory,”
Wall Street Journal, October 4, 2011.

“The Dow Jones Industrial Average turned in its worst Thanksgiving-week performance since markets began to observe the holiday in 1942.”

Steven Russolillo. “Investors Go Shopping – Just Not for Stocks,” *Wall Street Journal*, November 26, 2011.

“Over the past three months, investor uncertainty about the soundness of bank balance sheets, manifested in the daily volatility of stock prices, is back up to levels seen historically only in advance of two great crises. ... This dynamic has played out twice before in the past 85 years—in the Great Depression and the panic of 2008-09—with devastating consequences for the broader economy.”

Andrew Atkeson and William E. Simon, Jr.
“The Rising Fear in Bank Stock Prices,”
Wall Street Journal, November 28, 2011.

“The managing director of the International Monetary Fund has raised fears that the world faces the risk of economic retraction, rising protectionism, isolation, and ... what happened in the ’30s (Depression).”

Hugh Carnegie and George Parker.
“IMF Chief Warns over 1930s-Style Threats,”
Financial Times, December 16, 2011.

“It is hard to avoid the conclusion that stock prices are levitating at over-inflated values, thanks to the herd-like behavior and collective fear of investment institutions.”

Financial Times, December 30, 2011.

“An escalation of the crisis would spare no one. Developed and developing country growth rates could fall by as much as or more than in 2008-09.”

Quotation attributed to Andrew Burns, head of macroeconomics, World Bank. Chris Giles. “World Bank Warns on the Risk of Global Economic Meltdown,”
Financial Times, January 18, 2012.

“This may be the unhappiest bull market ever. We love to hate it, but that may be just egging it on.”

Tom Petruno. “The Unhappiest Bull Market Ever,”
Los Angeles Times, February 12, 2012.

“US companies are more uncertain about the future than at any point since the financial crisis, with just one in five of the biggest corporations making any predictions as they published quarterly results.”

Ajay Makan. “Doubt Haunts US Company Results,”
Financial Times, February 21, 2012.

“For nearly a decade, it turns out, the most accurate forecasts have come from the fringe. So it’s upsetting to learn that many of these Cassandras now believe, for different reasons, that we are on the brink of another catastrophe that may be far worse.”

Adam Davidson. “Sorry to Break It to You,”
New York Times, February 5, 2012.

“It remains clear that this almost uninterrupted equity market lacks substance and conviction. The rally’s volume has been very weak, and institutional operators have been absent from the market. There has been very little participation from the retail investor, based on data from Lipper, a provider of information and ratings on mutual funds. Corporate insiders have been big sellers of stock, exceeding \$6 billion last month (with the ratio of selling to buying hitting the astronomical 13-to-1 mark).”

David Rosenberg, chief economist and strategist, Gluskin Sheff. “The World is Not Fixed and This Equity Rally Lacks Conviction,” *Financial Times*, March 15, 2012.

“No one sees a growth rate fast enough for the American economy to return to full employment any time soon.”

Joseph Stiglitz, Nobel laureate 2001. “The American Labour Market Remains a Shambles,” *Financial Times*, March 13, 2012.

“We think that most of the US market is just not worth investing in. ... And it’s our belief that profitability will have to come down and the market isn’t priced for it.”

Quotation attributed to Ben Inker, head of asset-allocation group, Grantham, Mayo, Van Otterloo. Jonathan Cheng. “Two Pros Weigh In on US Stocks,” *Wall Street Journal*, April 2, 2012.

“It’s simple arithmetic, and it leads to a simple yet alarming conclusion that unless current law is amended before year-end, the stock market has to fall by at least 30%.”

Donald J. Luskin. “The 2013 Fiscal Cliff Could Crush Stocks,” *Wall Street Journal*, May 4, 2012.

“Stocks have not been so far out of favor for half a century. Many declare the ‘cult of the equity’ dead.”

John Authers and Kate Burgess. “Out of Stock,” *Financial Times*, May 24, 2012.

“The US economy is continuing to lose momentum just as global events that could derail the recovery gather steam. ... The downshift couldn’t come at a worse time. Experts warn that a breakup of the euro zone could spark the worst credit freeze since the collapse of Lehman Brothers in 2008.”

Ben Casselmann and Phil Izzo. “Recovery Slows as Global Risks Rise,” *Wall Street Journal*, June 16, 2012.

“‘Dr. Doom,’ Nouriel Roubini, says the ‘perfect storm’ scenario he forecast for the global economy earlier this year is unfolding right now as growth slows in the US, Europe, as well as China.”

Ansuya Harjani. “Roubini: My ‘Perfect Storm’ Is Unfolding Now,” *CNBC*, July 9, 2012.

“Bill Gross, co-founder and co-chief investment officer of Pacific Investment Management Co., says stock investors should rethink the age-old investing mantra of buying and holding stocks for the long run. ... Stocks, he says, operate much like a Ponzi scheme, showing returns that have no real bearing on reality.”

Steven Russolillo and Kirsten Grind. “Bill Gross: Stocks Are Dead and Operate Like a Ponzi Scheme,” *Wall Street Journal*, August 1, 2012.

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