

# Ostrich Investors

The withering barrage of misfortune that investors have suffered defies belief. Last year's horrific 38.5% loss in the stock markets was one of the worst ever witnessed. And this year has offered little respite, with stocks down another 5.7% so far. Such a catastrophic loss of wealth has naturally sparked rampant bearishness, pessimism, and a pervading sense of despair.

Add in fears of bankruptcies, smothering tax increases, and even a new depression driven by slower consumer spending, and it is easy to understand why countless investors have simply thrown up their hands in disgust. Capitulation, surrendering to this situation, seems to be the only viable strategy left for countless shell-shocked investors. They cannot bear to even *think* about investing anymore.

This approach reminds me of the ostrich, an impressive animal. Even though they can stand 9 feet tall and weigh 300lbs, this mighty bird can run at 45mph. Its kick is powerful enough to shatter the biggest bones in humans, and sometimes proves lethal. Yet by metaphor, this king of birds has the reputation of hiding its head in the sand in the face of danger. While not literally true, this ostrich analogy is useful.

Most investors today are acting like the classic literary ostriches, they are burying their heads in the sand. In an effort to escape the acute stress spawned by the stock panic, they are shunning investing. They are ignoring their own investments, unwilling to see how they are doing. They have ceased following the stock markets, lest the action rekindles the torturing financial pain they are desperately trying to escape.

I call this defense mechanism the Ostrich Fallacy. Ignoring problems, and hoping they will just go away, seldom brings good solutions. If you see a water stain in your ceiling, presumably caused by a leaking pipe, do you ignore it and hope it will magically vanish? If your child is getting in trouble, do you just stop trying to help? Of course not! Even though working through any problem is stressful, you seek a solution.

Problems in investing should be treated no differently. And given the importance of investing for our futures, I believe problems there should be assigned a much higher priority than most other problems. Burying your head in the sand for investing is actually shirking your responsibility for your own financial future. Will you hobble your dreams, your children's education, or your retirement by ignoring investing?

Yes, your paper wealth dropped precipitously in the past year. And it feels terrible. Welcome to the club, as virtually everyone in the markets lost money through the stock panic. But while the past is not changeable, the future is.

Tomorrow's success or failure is built on the decisions you make *now*. And those who face these tough times head-on, learning and growing, have a vastly higher probability of emerging successful than the cowering Ostrich Investors.

Tragically, each year in the US many communities are ravaged by natural disasters. And seeing your house wiped out by a hurricane, or flood, or tornado, or wildfire has to be orders of magnitude worse than losing paper wealth in the stock markets. Can you imagine, after losing your house, giving up and sulking in despair in the ruins? Despite the stress, the pain, you'd get on with rebuilding. So too must prudent investors.

Our ally in this struggle is information. If you are uninformed or misinformed, your despair will only grow. But armed with the right knowledge and perspective, the task of rebuilding investment portfolios becomes much more manageable. The Biblical book of Proverbs states, "A wise man has great power, and a man of knowledge increases strength." This is where our modern "knowledge is power" phrase comes from. And in few places does this great truth ring more true than in the stock markets.

As a lifelong student of the markets, the plight of the Ostrich Investors breaks my heart. As a speculator I live by the sword and die by the sword financially, so I well understand their pain in losing money. Yet if they could find the strength to lift their heads from the sand, and start surveying the financial landscape, they would find far more hope than in hiding. A few scraps of knowledge, a few morsels of wisdom, make all the difference.

For instance, most people tend to assume that the prevailing stock-market levels are a fair representation of what is happening (or coming) in the underlying real economy. Therefore if stocks are down 50%, they must be presaging an economic depression. Yet this assumption is not true, especially over the short term. It is greed and fear, collective psychology, that drives the stock markets from day to day, not fundamentals.

Thus when people are euphoric, like at the height of the tech-stock bubble in early 2000, their greed causes them to bid stock prices far higher than their underlying earnings power justifies. Popular greed leads to a widespread belief in a wildly bullish future that can't possibly come to pass. And of course soon after this greed climaxes, stock prices fall. Such emotion-driven overvaluations never last for long.

The opposite end of the emotional spectrum is fear. During the stock panic, we saw fear reach [epic levels](#) never before witnessed. While greed causes traders to buy too aggressively, fear leads them to *sell* too aggressively. So stock prices fall to dismal levels far lower than their underlying earnings power would ever mandate. This fear manifests itself in a belief in an extremely bearish future far

beyond the realm of possibility. After this fear reaches maximum intensity, burns itself out, stock prices naturally start rising again.

If you visualize real economic progress as a straight line gradually rising from left to right, stock-market levels are a sine wave oscillating around this line. Sometimes, at the wave crests, greed drives stocks way too high for their future economic prospects. At the wave troughs, fear drives stocks way too low for their future economic prospects. It is only in the middle of these sentiment waves, not at the extremes, where stocks are fairly representing their underlying business economics.

We are slowly emerging from just such a fear trough today, so stock prices are far lower than economically justified. Don't fall into the mental trap of looking at your investments and extrapolating their current low prices out into infinity. They are *an anomaly* that will soon pass, not a new low equilibrium that will persist forever. As fear abates, the vast majority of stock prices will rise dramatically to reflect a post-panic economic reality much better than the worst-case scenarios feared.

And the ultimate worst-case scenario is a new Great Depression. This dreaded D-word has been thrown around aggressively lately, especially in November and March when the stock markets plunged to new lows. This is because the prevailing levels of the stock markets actually drive popular psychology, even among non-investors. And the only way the recent dismal stock prices would be economically justified is if a new depression indeed looms.

While many people casually talk depression, few have actually studied the Great Depression to really understand just how bad such an event truly is. Between 1930 and 1933, the US economy (real GDP) contracted by 8.6%, 6.4%, 13.0%, and 1.3% respectively. Adjusted for inflation, US economic output plunged 26.5% in 4 years. This is a compound annual rate of shrinkage of 7.4%, which ultimately led to catastrophic job losses. 4.8% of US jobs vanished in 1930, 6.5% in 1931, and 7.1% in 1932. The Depression's peak unemployment rate was a staggering 25.2% in 1932!

This is scary stuff, no doubt. A quarter of the US economy wiped out and 1 of 4 Americans out of work would probably indeed justify today's dismal stock prices. But despite the popular misconceptions driven by the stock panic's extreme fear, fortunately the economic data today is nowhere close to suggesting a neo-depression is at hand.

In 2008 where the stock markets lost 38.5% of their value, the US economy actually grew by 1.1%. Yes, *grew!* So we haven't even seen any annual economic contraction yet, compared to 4 years of continuous contraction in the early 1930s.

The fourth quarter was certainly bad as the stock panic scared consumers into spending less, hurting business profits and stock prices. Q4 real GDP contracted at a 6.3% *annualized rate*, which works out to an absolute economic contraction of 1.6% in a single quarter. The preceding Q3 2008 fell at a 0.5% annual rate, a very slight absolute contraction. And even if Q1 2009 is as bad as economists expect, 3 quarters of negative growth hardly make a depression. A recession certainly, but a depression needs *years* of shrinkage.

In 2008 we did indeed see job losses, which is always concerning. But they only ran 2.2%. This is less than half of the *best* Great Depression year and less than a third of the worst. There is simply no comparison. And unemployment so far in our current crisis has merely peaked at 8.5%, about a third of the peak in the Great Depression. 11 out of 12 Americans who want to work still have jobs today, and they are still spending.

Wall Street analysts and economists are scared, just like investors. So they are assuming that the low stock prices are rational, and the only way they can be rational is if a neo-depression is coming. Yet if you compare the actual economic data today with that seen in the Great Depression, it is immediately obvious that today's event *isn't even close*. And a mere recession, even a severe one, means stock prices are far too low today.

The precipitous plunge in stock prices in October and November during the height of the panic sparked the extreme fear that led to today's irrational fears of a new depression. But this very plunge took stocks to levels where they are screaming buys. Another scrap of knowledge that every investor should know easily makes this point. Ostrich Investors would do well to heed this illuminating market history.

Just as popular greed and fear drive short-term stock prices, they drive great long cycles throughout stock-market history. I call these the Long Valuation Waves and have studied and [written about them](#) extensively. Over a 34-year cycle, the stock markets gradually meander from undervalued to overvalued and back again. The first halves of these cycles are secular bull markets, like from 1982 to 2000 where the stock markets soared 1400%. The second halves are secular bears, like from 1966 to 1982.

Secular means lasting a long time, and 17 years is certainly a long time. Many investors mistakenly think the stock markets always grind lower in secular bears, but in reality they grind *sideways*. A secular bear is a 17-year period of time, half of a Long Valuation Wave, where stocks make little headway. This sideways movement is necessary because stock prices were too high relative to their earnings power at the end of the preceding secular bull. By grinding sideways, stock prices give underlying earnings time to catch up.

We are in another secular bear today, it started back in early 2000 at the peak of that mighty secular bull. So the stock markets are likely to grind sideways on balance until 2016 or so, not far exceeding their 2000 highs at best. But *within* this long secular-bear span, there are cycles of shorter bull and bear markets lasting a few years each. These are known as *cyclical* bulls and bears. As this next chart shows, we are likely entering a new cyclical bull within a secular bear. This is a time of great opportunity for investors.



The red line here shows the flagship S&P 500 stock index from 1966 to 1982, the last secular bear. That was a time of out-of-control spending and crushing taxation from Washington, and the resulting inflation, much like today. The blue line shows the S&P 500 (SPX) in our current secular bear since 2000. Note that the stock markets traded sideways on balance within both of these great secular bears.

But within their giant secular trading ranges, there were powerful cyclical bulls and bears. And they form a pattern even a 3-year-old could recognize. Bear, bull, bear, bull. We saw a cyclical bear between 2000 and 2002 where the stock markets were *cut in half*. Then we saw a cyclical bull between 2003 and 2007 where the stock markets *doubled*. Then another cyclical bear emerged, ultimately leading to stocks being cut in half again today. After bear, bull, bear, where does that leave us today? At the dawn of a new cyclical bull!

Even with all the economic problems out there, even within a secular bear, the stock markets will probably *double* in the coming years. This wouldn't take them to new highs, just back up near the top of their giant secular trading range. This

means putting one's head in the sand, giving up on investing, is exactly the wrong thing to do today. If the stock markets indeed double again in the years ahead, some sectors of stocks will radically outperform the general market. Fortunes will be won! But not by the Ostrich Investors.

Another morsel of knowledge most investors don't know is that the biggest up years ever witnessed in stock-market history immediately follow the biggest down years. Last year's stock panic, sandwiched within a normal and expected cyclical bear, drove one of the biggest down years ever. So believe it or not, odds are 2009 is going to prove to be one of the biggest up years *ever*. After the infamous [Panic of 1907](#), the last true stock panic, 1908 saw an epic 46.6% gain!

Now if this information is new to you, the hard truth is this is only because you haven't looked for it before. Knowledge only comes to seekers, not the apathetic who don't care nor the fearful who hide like ostriches. I was writing publicly, and preparing our subscribers, for this 17-year secular bear back in [2000](#) and [2001](#). In January 2008, when the stock markets remained near highs, I used a similar chart to the one above to warn investors that [a new cyclical bear](#) was starting to unfold. There is no excuse to be caught unaware.

Not everyone has the interest, aptitude, or good fortune to be able to study the financial markets all day everyday for a lifetime as I have. It is impractical for all but the most fanatical traders. But thankfully you don't have to. If you spend a couple hours a week learning about the markets, and investing, your knowledge *will* grow. And after enough years of this modest commitment, the tangible and intangible dividends you accrue will grow exponentially like compound interest.

When I was learning about the markets, investment, and speculation in high school, my father introduced me to financial newsletters. I was hooked. Here I, a kid, could spend little money yet I had direct exposure to the deep analyses and shrewd investment strategies from some of the sharpest minds out there. I learned much, drinking in the wisdom of these hard-working gurus. By sharing in the fruits of their labors, my knowledge grew rapidly. That experience sowed the seeds for a dream I realized nearly a decade ago of launching my own financial newsletters.

I love living and breathing the markets. They are so exciting and fun, perpetually changing and always challenging, yet usually operating within the bounds of precedent. I get to study them full-time, and help others thrive from the fruits of my labors through the financial newsletters my company publishes. It is awesome. Ostrich Investors, spending a few hours a month learning about the markets from my team that studies them without ceasing, could radically change their future investment success.

At Zeal, we study all the markets but our primary focus is on commodities stocks. Despite the turmoil the stock panic caused, all over the world people are striving

diligently for higher standards of living for their families. This will require huge amounts of raw materials, far more than the world has ever seen before. Commodities producers are thriving in this environment. They have rallied mightily since 2001 when I started writing about the [new secular commodities bull](#), they rallied strongly between November 2008 and March 2009 when general stocks *fell*, and they will rally in the future as the best is yet to come.

If you are scared, and have bought into the Ostrich Fallacy of ignoring your investments, dust yourself off and get back in the game. Sure, the challenges are great today, but so are the opportunities. And only by understanding the markets can you ever hope to thrive in them. For about the price of a single lunch each month, you can subscribe to our acclaimed [Zeal Intelligence](#) monthly newsletter. We'll help grow your knowledge at a deep level, positioning you for future investment success. [Subscribe today!](#)

The bottom line is we've just experienced a rare stock-market panic, but the world hasn't ended. Fear got out of hand but it is already abating. Today's economic data merely shows a recession, but stock prices are discounting a full-blown depression. Gradually they will climb higher to reflect a much-less-dire economic reality. And a new cyclical bull is being born, which happily coincides with a post-panic year likely to see huge gains anyway.

Being stressed is no excuse to shirk your financial stewardship duties. The solutions to any problems aren't found by ignoring them, by hiding like an ostrich, but by facing them head-on. Learn about the markets, grow your investing wisdom and knowledge. Never surrender. Your future wealth is defined by your decisions today, and the Ostrich Investors are squandering incredible opportunities.

Adam Hamilton, CPA

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So how can you profit from this information? We publish an acclaimed monthly newsletter, [Zeal Intelligence](#), that details exactly what we are doing in terms of actual stock and options trading based on all the lessons we have learned in our market research. Please consider joining us each month for tactical trading details and more in our premium Zeal Intelligence service at ... [www.zeallc.com/subscribe.htm](http://www.zeallc.com/subscribe.htm)

Questions for Adam? I would be more than happy to address them through my private consulting business. Please visit [www.zeallc.com/adam.htm](http://www.zeallc.com/adam.htm) for more information.

Thoughts, comments, or flames? Fire away at [zelotes@zeallc.com](mailto:zelotes@zeallc.com). Due to my staggering and perpetually increasing e-mail load, I regret that I am not able to

respond to comments personally. I will read all messages though and really appreciate your feedback!

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