

Expect a market rebound

Today's pessimism dismisses history's lessons

By Ric Edelman

From a stock market perspective, the best news about 2008 is that it's over. Sure, the economy is still weak, but don't assume that the stock market will remain so.

Indeed, stock prices are likely to recover well before the economy. That's because prices reflect investor expectations of future corporate profits. Because we can envision profits before they are earned, stock prices can rise ahead of any economic rebound.

We are already seeing positive signs. The drop in gas prices since July is the equivalent of a \$300 billion stimulus package. Furthermore, panicked investors have been selling so many shares for so many months that, according to Bloomberg, 2,267 companies now hold more cash than the total value of their stock and debt. So you could buy all the shares of any of these companies, shutter them, pay off their debt — and still have a tidy profit.

Let's put that in real estate terms. Imagine buying a house, paying off its mortgage and then burning the house to the ground — and then selling the land for more than you had paid for the house. That's the status of stock values today. In 2002, when the stock market bottomed after a three-year bear market, only 276 companies worldwide were in this same situation.

It's safe to say that stock prices have fallen to absurdly low levels, and that investors will eventually come to their senses. When they do, prices are poised to skyrocket — thanks largely to the \$8.9 trillion sitting in cash, most of which had been invested in stocks.

History proves this point. After all, severe declines are part of the normal market cycle, and although they feel substantial at the moment (and sometimes are), losses have always been followed by dramatic recovery. This is reassuring for those who have watched their investments suffer, and exciting for those who have cash and can buy additional shares while prices are so low.

For example, the S&P 500 fell 89% during the Great Depression

(from its 1929 high to its low in mid-1932). But few recall that the S&P 500 then skyrocketed, rising 206% over the next three years. If you were in the market for the whole ride, you lost two-thirds of your money, but if you got in at the bottom, you tripled it.

It was similar in the deep recession of the 1970s. After the S&P 500 fell 48% from December 1972 to October 1974, it jumped 73% over the next two years.

Want more recent data? After the S&P 500 fell 49% from March 2000 to October 2002, stocks doubled in value, rising 102% from October 2002 to October 2007 — which brings us to today. Prices have been down for 14 months, and while prices may stay low or fall even further, guess what's likely to happen next?

Yes, history tells us that prices will recover, but history tells us even more. In each stock market recovery, prices rose shockingly fast. Since World War II, there have been 13 recessions. On average, the stock market rose 36% in the year after each one, according to Ibbotson Associates.

So if you've been thinking of selling, think again. Instead of dwelling on the recent past and worrying that the world is coming to an end, start getting excited about what could await you.

Today's stock prices represent the greatest buying opportunity of a lifetime, and in 20 years, you'll either tell your grandchildren that you bought at these historically low prices, or that you wish you had. Your choice.

But remember: Long-term investors mustn't fret about today.

Nobody knows exactly when the market recovery will begin. But one fact is clear: You won't notice that prices are rising until they already have begun to rise. And by then, it's too late.

So here's toasting prosperity, and, sure, a little optimism, for the new year.

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