

Wall Street always seems to be predicting the end of some trend.
Investors should be wary of acting on these forecasts.

Major Trends Just Keep Going and Going...

by Dick Davis



Well-entrenched market, stock, interest-rate or economic trends are very difficult to reverse.

A TOUGH PART OF AN INVESTMENT ANALYST'S JOB IS forecasting change, especially trying to predict when that change will occur. What makes it difficult is that at any given time, the odds favor a trend that's in force remaining in force. In its early stages, it's unclear whether a developing trend will last. But once it takes hold, once it gets its sea legs and gets used to its surroundings, it's usually reluctant to go away.

This type of stability is often viewed with skepticism by an investment world in constant flux. It's a world where stocks, groups and styles continually move into and then out of favor. It's a world of shifting currents with a myopic focus on the short term. And it's the kind of world that typically forecasts the demise of any trend that perseveres to multiyear status.

I believe an awareness of this concept of major trend durability can be a big help to investors. It can prevent buying or selling too soon. Still, it's seldom discussed. That probably has something to do with the obsession of Wall Street and the financial media with news of the here and now. This need is so intense and all-pervasive that it blots out what matters to most investors—what happens over the long term.

The truth is that well-entrenched trends, whether they apply to the overall market, stocks, interest rates, inflation or the economy, are exceedingly difficult to reverse. The stock market went from Dow 776 in 1982 to Dow 11,722 in early 2000, an 18-year bull market. Interest rates on the 10-year U.S. Treasury bond declined from almost 16% in 1981 to 3.07% in June 2003. That's a 22-year bull market. Inflation dropped from 13.6% in 1980 to 1.14% in 2004. That's an 24-year downtrend. The economic expansion that started in 1991 ended in 2001.

Perhaps the persistent domination of value, small-cap, and real-estate-investment-trust stocks is the most impressive example of major-trend durability. Each of the past few years has started with forecasts of "this year, large-caps will be the place to be." In the meantime, by mid-2006, small stocks were entering their eighth year of outperforming big-caps. And by year-end 2006, despite predictions of their demise, value stocks extended their supremacy over growth stocks and REITs surpassed the Standard & Poor's 500 index, both for six years. The longer the streak, the more numerous and certain are the forecasts that it will end.

In 2007, we've seen a halt to these trends. Analysts right now are debating whether they're over. The market's climb to Dow 14,000 was led by growth, large-cap and technology. If, indeed, 2007 marks a year of transition if not one of change, there's no denying the former leadership had a great run. The same goes for the trend of the overall market. At five, going on six, the bull is old. But despite the increased volatility in 2007, the Dow, so

far, has dropped by only about 10%. That's a full-blown correction but still some distance from the 20% erosion that constitutes the classic definition of a bear market. The overdue bear *will* come and it may already be on its way (many individual stocks are down 20% or more), but there's a lot more pain in store before it becomes official. In the meantime, perhaps not for long, all the major indexes are still up for the year.

Of course, no major trend goes straight up. There are always corrections or countertrends, some quite long, along the way. But in all of these examples, the primary underlying trend prevailed. Once grooved in, major trends often show amazing durability. Their staying power is consistently underestimated by Wall Street.

Like everything else in the investment world, there are always exceptions. By definition, a trend is major because it has achieved a certain maturity, but not all major trends last beyond expectations. What we can say is that the longer it endures, the more likely the principal of the durability of major trends will apply. It's similar to the reasoning behind projected-life expectancy. The 60-year-old male with a life expectancy of 80, once he turns 80, is expected to live another eight years and then another five after that.

Occasionally I'm wrong about a trend's perseverance, but more often than not, widespread expectations of the demise of an aging trend prove premature. Part of investing is dealing with extremes. Extended markets typically become more extended, and extended trends in individual stocks tend to do the same.

One caveat: Downtrends in the stock market typically don't last as long as uptrends, so the durability principle is less likely to apply. The shorter life of market declines means they have less time to dig in (the great crashes of 1929-1932 and 2000-2002 lasted less than three years). A sideways or range-bound market, however, can last and last. It took the Dow 17 years, from 1965 to 1982, before it broke out of the 600 to 1,000 range.

Investors who can develop the patience and discipline to stay with the major trend, and are not faked out by the false countermoves along the way, are likely to be pleased and surprised at just how far it will take them. A quiet but confident awareness of this recurring phenomenon in market history will provide an edge. It will prevent the disturbance of solid positions and help keep investors on the right side of the market. And it will make it easier to put into proper perspective the daily onslaught of short-term news and opinion. ■

This story is an excerpt from *The Dick Davis Dividend*, a book published this week by John Wiley. Based in Boca Raton, Fla., Davis is a retired broadcaster, syndicated columnist and founder of the Dick Davis Digest newsletter.

The Bottom Line

Investors should avoid buying or selling too soon on predictions of the imminent collapse of a certain trend and should keep an eye on what the long-term will hold.