U.S. Stock Markets Hit All-Time Highs—Does it Matter?

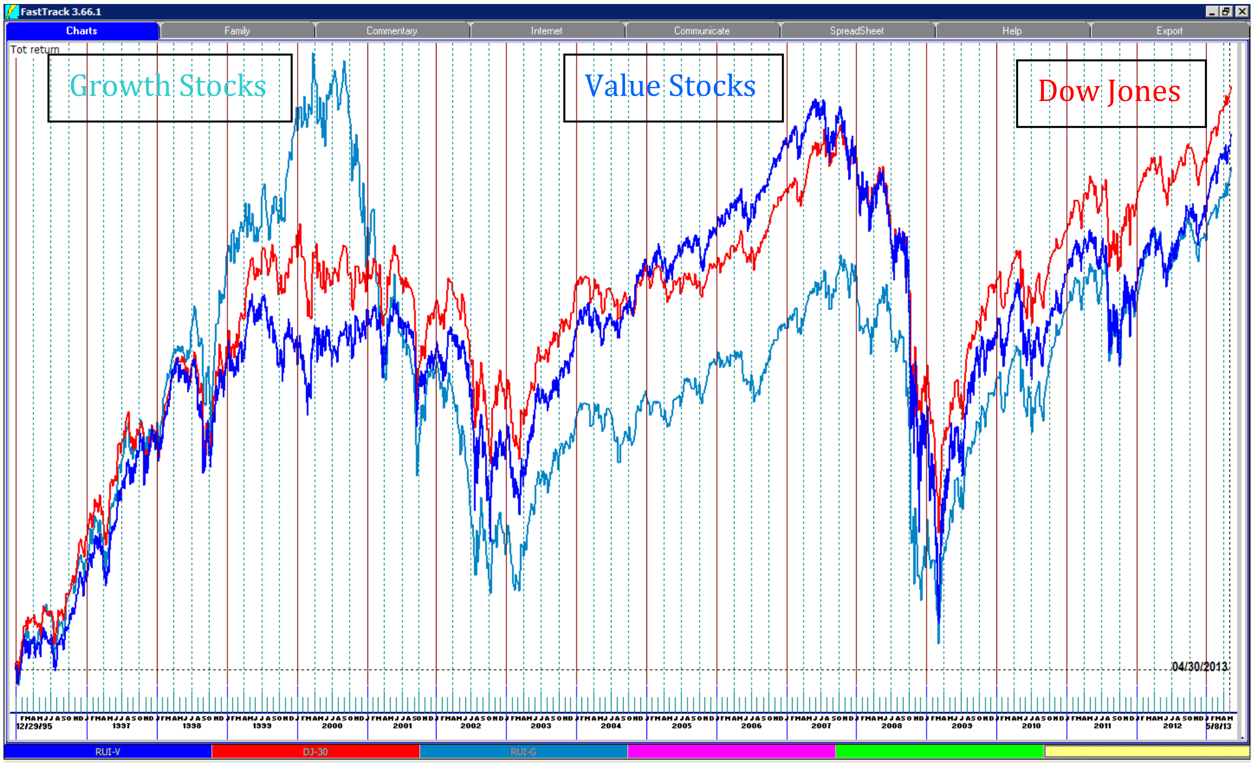
April Market Review From Your Portfolio Management Team—May 13, 2013

Finally! After four years of clawing their way back from the depths of the bear market of 2008, the majority of U.S. stock market indices have broken through the prior highs that were last seen before the Financial Crisis hit back in late 2007. Stocks appear to be following up with their strong returns in the first quarter with additional gains in April (and so far in May). Investors seem to be responding as well, with stock funds continuing to report positive asset flows. Should we assume that it is 'all systems go' and time to jump (100%) on board this rally?

Well, let's look a little deeper. First of all, when you hear the media say that 'stocks are hitting their all-time highs,' let's put that into context. For the S&P 500 index and the Dow Jones Industrial Average, it is true. These indices have hit new high levels. It is also true for smaller companies. However, Growth stock indices (which include a high allocation to technology companies) have eclipsed the highs from 2007, but remain well below the highs they hit back in early 2000. The Nasdaq index is also considerably below its high from 2000, due to its traditionally high allocation to technology stocks. On other hand, Value stocks (which include a high allocation to financial companies) are still below their highs from 2007 since financial companies were at ground zero when the Financial Crisis hit in 2007.

The graph below shows the variations in performance among some of the broad indexes throughout this period. Indexes with high technology weightings (such as the Russell 100 Growth index shown in tourquoise) suffered greatly in the 2000 – 2002 bear market and still have a ways to go in order to break out to new highs. Indexes with high financial weightings (such as the Russell 1000 Value index shown in blue) suffered greatly in the 2008 bear market and still have some room to go in order to break out to new highs.

The more diversified indices (such as the Dow Jones Industrial Average shown in red), with moderate allocations across most sectors, rather than being concentrated among a few sectors, have managed to break to new highs, but it is far from a universal occurrence. In addition, most overseas markets remain below their prior highs.



Of course, the other question we feel compelled to ask in the face of all the media fanfare over new highs is, "What took you so long?" It should not be lost on anyone that it took almost 6 years for these indices to surpass their previous highs from 2007. The stock portfolios of most retired investors are probably still below their 2007 values since they are making withdrawals to help fund their retirement living.

On the other hand, the four FSA strategies that invest, at least to some degree, in stock funds all hit new highs in less than 3 years from their 2007 peaks. This highlights why we focus so much attention on downside protection: It is much easier to climb out of a small hole than it is a large hole. Said another way, if we can avoid much of the losses that occur in down markets, we don't need to take the risk of capturing all the gain in the good periods. FSA clients get a smoother, more comfortable journey and can rest more easily knowing their portfolios aren't always fully exposed to the vagaries of the stock market.

At times like these, with the media harping on the new highs, it can be frustrating if our strategies are not keeping up with these indexes, but hopefully, you can gain satisfaction knowing that your portfolios have been hitting new highs for almost 3 years.

Ronald Rough
Director of Portfolio Management