

# The Great Crash of 2008?

As of October 10th, the S&P 500 is down 37% for the calendar year, a decline unmatched since 1931's slide of 43%. And unlike the crashes of 2000-2003 and 1973-1974, diversification into different asset classes has not reduced the carnage. International and small stocks have been hurt even more than the U.S. blue chips. There is a massive crisis of confidence leading to doubts about whether individual companies will be able to survive the lack of credit to run their businesses, the latest such victim being General Motors, which on October 10th lost one-third of its market value.

We know that you may be scared, and fear is very understandable. Investors everywhere are facing uncertainty about how this will play out, and over what time frame. Let's examine three **possible** scenarios, based on three of the largest market crashes of the last century:

## Crash of 1929: What if we're halfway into another Great Depression?

### Then:

The Great Depression, which began in 1929, saw the S&P 500 decline by 64% from January 1, 1929 to December 31, 1932. This was a time when unemployment rose to 25% and almost all families had a single breadwinner. The national income (GNP) declined by 30%.

### Now:

The drop in value from January 1, 2008 to now is about half as much as the drop during 1929-1932. Unemployment is about 6% and GDP is still relatively flat. Almost all of the decline in today's market values is being attributed to the fear that companies will not be able to earn ample profits without the same access to capital they've enjoyed in the past, and that consumer spending will slow dramatically without the easy and cheap debt of recent years.

### Our Analysis:

We have tested which allocation between stocks and bonds survived the Great Depression the best, for someone who was already withdrawing 5% of their principal each year (e.g. taking out \$20,000 from a \$400,000 portfolio). The answer was 60% stocks and 40% bonds, even though it took 14 years for stocks to bounce back to pre-1929 levels. Over long periods of time, investors with moderate amounts of equities (40-70%) were able to have sustainable withdrawals over a longer period.



## Crash of 1973-74:

### Then:

In 1973-74, the S&P 500 lost 38% of its value. The decline was driven by a combination of Vietnam War debts (and anti-establishment sentiment among much of the populace), the oil embargo by OPEC, Nixon's impeachment and the Watergate scandal. Inflation was rampant, and the Fed was pumping more money into the system, the exact opposite of what they should have done. The market didn't return to its 1972 values until 1976, more than three years after it began. (based on S&P 500 index)



### Now:

If the current market decline plays out as it did in 1973-1974, it will be 2012 before we're back to last year's levels.

### Our Analysis:

The 60/40 allocation mentioned above still did well relative to an all stock or all cash allocation, because inflation was so high. Investors who had more of their money in equities did the best during this period because equities kept pace with the high inflation during this time.

## Crash of 1987: "Black Monday" - A severe crisis of confidence; markets rebound quickly once liquidity is restored to the system.



### Then:

After a decline of 34% over just three months, the S&P500 took only 18 months to reach its pre-crash level. The market enjoyed a 60% rebound over the subsequent three years (from 12/87 to 12/90). Many retirees missed this rebound sitting in cash, and ended up having to cut spending 25% or more because their capital had been so eroded.

### Now:

If the current market decline plays out this way, it will be 2010 before we fully recover.

### Our Analysis:

We can basically buy the same dollar of company earnings or profits today for 40% less than we could a year ago. If that deal were available on your real estate income property, you wouldn't hesitate. Stocks somehow seem mysterious because they just show up as numbers on a statement or a topic on the nightly news. But the reality is that you are becoming an owner of a business when you buy stock, even through index funds. As with any asset, you're most interested in what multiple you have to pay for its earnings, and that multiple is lower today than anytime in the last 25 years.

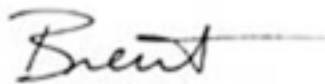
## What Abacus Is Doing

- ◆ We are continuing to index, because at a time like this, you certainly do not want to be making bets on specific companies or industries. Part of the reason prices are so low is that most investors buy individual companies, not entire markets. The uncertainty of who will survive creates extra downward pressure on each company's stock price. Index fund investors buy entire markets, not individual companies. As long as capitalism survives, those who own entire markets will prosper, even if many companies go bankrupt during this process.
- ◆ We are continuing to rebalance your portfolio to keep your allocation on target. The result is that we are using the proceeds from assets which held their value, relatively speaking, to buy discounted equities. This kind of disciplined rebalancing causes us to buy low and sell high, which can lead to significantly higher returns over time.
- ◆ We will be tax-loss harvesting for most non-retirement accounts between now and year-end. This will create a 'bank account' of losses which can be used to shelter future capital gains from tax (which may well be taxed at higher rates than today's 15% federal rate).

Our years of experience and actual statistical evidence have taught us that those clients who watch the most news tend to have the most fear and make the most unwise financial decisions.

Please call or email your advisor if you need to talk strategy, discuss what we are doing in your portfolio specifically, or want to know what these declines mean for the funding of your future goals.

Warmly,



Brent Kessel  
President



Spencer Sherman  
CEO

## What You Can Do

- ◆ If you are not working and are withdrawing more than 5% of your total portfolio value, aim to cut your spending if possible so that your withdrawals will be 5% or less of your current portfolio value. If you are not withdrawing yet, invest as much as you can.
- ◆ Avoid focusing on recent results as predictive of the future. As behavioral economist Meir Statman says,

"What I know from my studies is that individual investors tend to extrapolate recent trends. If stocks are going down, they think stocks will continue to go down. I also know that generally, those expectations turn out to be wrong. When people are most pessimistic, the likelihood is greater that the market will go up."

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