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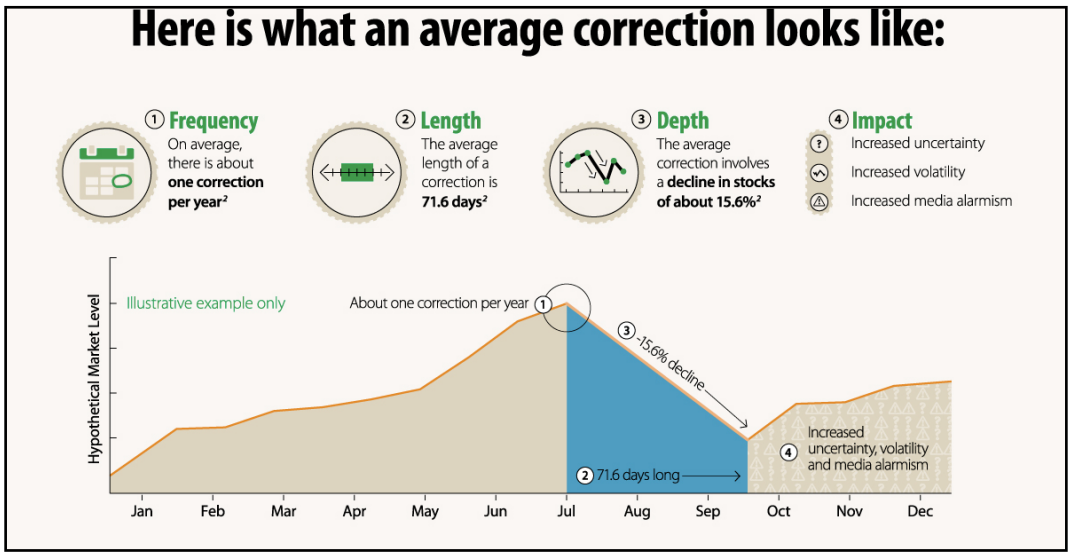
Corrections - What are they and should we worry about them?

By Keith Burbank - Chief Investment Officer

Heard the Market has hit new highs? Worried about the next correction?

Every investor gets excited when they hear the market has notched new all time highs. Investors invest to make more money, so of course hitting new highs is the goal. Hitting new highs is not that rare of an occurrence; over the last 100 years the market has hit a new high on 5% of all trading days, an average of 12.6 trading days per year, or once every 4 weeks.

So why does it seem like as soon as we reach new highs, investors immediately turn their worry to the market correcting? And what exactly does a correction mean?



The answer to the first question is quite simple. Most investors assume the market can't keep going up forever. In the short term this is true, the market is not up everyday, month or year. Long term, on the other hand, the market has steadily increased at an annualized average of 10% (large cap stocks). In the last 107 years the market has been up 73 years (68%) versus down 34 years (32%). So no it doesn't go up every year, but 2 out of every 3 years on average the market is up.

Even more impressive, the market is rarely down more than 1 year in a row. There is one occurrence where it was down 4 years in a row (during the great depression). Two times it was down 3 years in a row (1939-1941, 2000-2002). Just two times it was down two years in a row (1973-1974, 1977-1978). Only 5 occurrences of multi-year negative returns, two of them occurring around the Great Depression and start of World War II.

On the upside the market has had 7 stretches of 4 or more years of positive returns, including a stretch of 9 years in the 1990's, and 6 years after the Great Recession of 2008. *- Continued on pg. 2*

Corrections - cont.

Now that we know what the stats say about the market returns, let's tackle the second question, what is a correction?

The technical definition is a decline of 10% or more in price from the most recent peak. Corrections do not necessarily happen all at once, and can take many days, weeks or even months to occur. We tend to remember market corrections or crashes that happen all at once, but frequently individual assets will take a long time to correct before starting their advance again.

Conventional wisdom seems to be that to be a successful investor, one must avoid corrections, by selling at the market top, and then reinvesting at the market bottom. If one could do this consistently, they would be very successful. Unfortunately, timing the market in this way consistently is nearly impossible, even for the most seasoned technical traders.

The reality is the only way to avoid corrections and crashes, is to not be invested in the market in the first place. Relying on a strategy of timing the top and bottom of short term market swings, has left many an investor with long term returns less than the market average. Instead having a long term investing strategy, that accounts for your risk level through asset allocation, while staying invested through market cycles, tends to have a higher degree of success in the long run.

Risk

By James G. Steproe, J.D. - President

Baseball notwithstanding, the dictionary definition of "safe" is "free from harm or risk". Sounds nice, but, like many things that sound nice, it is just not real. Please, allow me to elucidate.

When I was a 'yute', New York for a child, my mother's instant response to almost anything I would ask permission for was, "Is it safe?". Hey, she was my mother; and you would expect that, particularly with a kid like me. After all, most things I wanted to do when I was 10, were not "safe" by any rational standards.

On the other hand, what is "free from harm or risk"? I honestly cannot think of a single thing. The real question should be, "Is it relatively safe?".

Leon Trotsky was right. Everything is relative, and nothing is absolute. Well let me say that nothing is absolute when it comes to safety because nothing is absolutely safe. Now of course, there is relative safety. Sitting at home watching television is clearly safer than riding a motorcycle while drunk at night during an ice storm. Ya think?! - *Continued on pg. 3*

Risk - cont.

On the other hand, you might think that sitting at home is "safe", at least until the house catches fire. In that case, you might not want to trade places with that guy out there on his motorcycle.

This safety question is not restricted to the actions of 10-year-olds or drunken motorcyclists (or even worse, a 10-year-old drunken motorcyclist). In fact, in some shape or form, proper risk analysis can and should be part of every human activity.

As we societally and individually deal with The Pandemic, we are all receiving a crash course in risk analysis. Of the three major vaccines currently available here in the United States one, from Johnson & Johnson, was in question. Of the roughly seven million who received a vaccine, seven women were found to have blood clots including one fatality. As sad as this is, the media put this on the front page causing what can only be described as a gross overreaction on the part of some of the public.

It is understandable that some of our fellow citizens, already nervous about vaccines, might overreact to the news. Many people felt The Center for Disease Control (CDC), may have over reacted too, when they decided to halt use of the Johnson & Johnson vaccine for a short period of time. After all, when you distribute a vaccine to seven million people you can be quite certain that the potential is there for a small percentage of those people to have an adverse reaction, for every reason imaginable.

The question of safety extends to many more facets of our lives; not the least of which is financial. When investment clients ask about safety, they are usually referring to the potential for market losses and it is something that they certainly should consider. If, however, their fear of losses prevents them from taking action that would have earned them a fair rate of return, they need to count the funds not earned as money lost. Even with a small rate of inflation, doing nothing to earn more than that rate will lower your portfolio's relative value by that same amount.

Fear is an important emotion, without it most of us would have perished a long time ago. It keeps us on our feet and aware of the danger around us. However, excessive fear is just as damaging, causing us to react emotionally rather than calmly and logically.

For a number of years, I was a private pilot, flying a small single engine airplane. From time to time, folks would ask me how I felt about partaking in this "dangerous activity". While accidents can and do occur, generally flying is as safe as you make it. These very same people would think nothing about driving in winter on an icy expressway covered in snow with vehicles weighing thousands of pounds passing them by at combined speeds approaching 150 mph. They think I'm brave!

Once again, the danger is one of perception. A pilot friend and his spouse were headed for a family event. They were using their private plane and for the first time my friend's mother-in-law was joining them. Lovely woman, but she did have a reputation for being a back seat driver. Since getting into the back seat of his plane required a certain amount of dexterity that his mother-in-law clearly lacked, his wife was in the back and her mother in front.

My friend was pleasantly surprised that he had not heard from Mom. That is until they were roaring down the runway to gain enough speed to take off when she suddenly cried out, "For God's sake will you please slow down!?" - As I have stated, fear is in the eyes of the beholder.