When to Put Your Money Under Your Mattress

For decades, the prevailing wisdom held that the way to sleep at night was to buy and hold stocks for the long term while ignoring market gyrations. But investors who had implicit faith in this philosophy of long-term investment had a rude awakening during the Great Recession.

Even the remarkable rally from the March 2009 market low has not repaired all the damage to their investment portfolios. In despair, many have concluded that the investment climate is just too uncertain to trust their hard-earned dollars to the vagaries of the stock market. That is a great pity, because managing the risk to a stock portfolio is not as hard as most believe.

The simple fact is that the worst bear markets are normally associated with recessions. Therefore, you should sell your stocks in anticipation of a recession, and buy stocks ahead of a recovery.

Fortunately, good leading indexes are designed to flag recessions and recoveries before they arrive. Not all leading indexes are created equal, but the best of them can help avert much of the damage that recessions wreak on stock portfolios. ECRI's leading indexes are a case in point.

In mid-September 2000, for the first time in nearly a decade, ECRI ↗*warned publicly* of a coming recession (see right-hand column of page). Then, in early February 2002, it made its economic ↗*recovery call*. Six years later, in March 2008, ECRI announced that the economy ↗*was in recession* – a call that remained in force until April 2009, when it predicted a ↗*recovery this summer*.

Mind you, these were not *stock market* calls, which ECRI does not make. (Full disclosure: On March 19, 2009, ECRI sent its clients what *Grant's Interest Rate Observer* described as a "table-pounding" missive: in Jim Grant's words, "The implication could not have been clearer that a market rally, when it started, would be no sucker's affair but the real McCoy.")

But it is still worth examining what would have happened to the value of a stock portfolio over the course of the last two recessions and recoveries if an investor had simply sold stocks on the day that ECRI *publicly* predicted a recession and bought back stocks on the day ECRI *publicly* predicted an economic recovery. It is instructive to compare this to a long-term buy-and-hold strategy for the S&P 500.

The results are compelling. If you had started with $100 in stocks on the day in September 2000 when ECRI publicly warned of recession and followed the standard **buy-and-hold** strategy, those stocks would be worth just **$72** nine years later, at the end of September 2009.

Alternatively, suppose you had sold all your stocks on that very day in September 2000 and put the cash under your mattress until the day in early 2002 when ECRI announced a recovery, at which point you used all of that money to buy stocks. Then, suppose you once again sold all your stocks on the day in March 2008 that ECRI made its next recession call, and used all of that money to buy stocks on the day ECRI made its 2009 recovery call.

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Following that simple **buy-low-sell-high strategy**, your stocks would be worth **$148** at the end of September 2009 – more than double what a buy-and-hold strategy would have given you. You can do the math – over the nine-year period, you would have beaten the buy-and-hold returns by more than **eight percentage points** a year, on average – and even more if you had put your money in money market funds instead of your mattress.

Of course, this strategy would miss sizeable rallies and corrections. It is hardly the best possible way to manage money – investment professionals with the time and resources to analyze an array of specialized state-of-the-art leading indicators should be able to do better still.

But the average person has little time to study the markets. For that person, the power of reliable leading indexes of recession and recovery can make the difference between a comfortable retirement and many extra years of work during his golden years.

We are now at a juncture where the importance of decent returns to repair many broken portfolios is painfully obvious. Yet, in such uncertain times, it is equally imperative to follow a low-risk strategy. The bottom line is that good leading indexes are invaluable for navigating these treacherous economic shoals, with the economy likely to dip in and out of recession in the years to come.

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