

Fall Newsletter (“Attention Contrarians”)

Attention contrarians! They are at it again - the financial press calling for “the death of equities” that is. Like Yogi Berra said – “It’s Deja-Vu all over again”. This time it’s the Wall Street Journal, which in its September 26, 2011 edition, ran a front page, right-hand column article entitled “Pivot Point: Investors Lose Faith In Stocks”. The article talks about “a sea change (that) is taking place across the financial markets” and supports its statement that “investors are abandoning the time-tested *stocks for the long run* optimism that (has) dominated since the late 1980’s” with statistics from EPFR Global showing the large sums of money (\$92 billion in the 3 months ended in August and another \$25 billion in the first three weeks of September) investors have withdrawn from stock mutual funds recently. The last time I saw one of these “death of equities” articles it was August 22, 2010 in the New York Times Page 1, Column1 entitled “In Striking Shift, Investors Flee Stock Market”. Like the recent Wall Street Journal article, this New York Times piece appeared after a period of significant stock market decline and volatility. It too cited the large amounts of money investors were taking out of stock funds. Contrarian investors, recognizing that it generally pays to go against the crowd, particularly when it attracts the attention of the press, did well following this pronouncement as the publication of the Times article pretty much coincided with a stock market turnaround that carried the major indices significantly higher over the course of the next several months. Is it time for the contrarian in all of us to wade in again against the crowd and buy stocks?

In my Summer newsletter (entitled “Investing in a 2 Speed World” published this past June), I argued that the rally in the U.S. stock market over the previous 2 years (that carried the S&P 500 to the 1370 level) had been driven “by super generous liquidity associated with the Federal Reserve’s easy money policy and not much else.” While I may have been somewhat cautious about the sustainability of the rally, I certainly didn’t predict the plunge that the market subsequently experienced from July 22 to August 9 that took the S&P down roughly 250 points (19%) in two weeks. And what a crash it was! As Carter Braxton Worth, Chief Market Technician at our affiliate Oppenheimer Asset Management Inc., pointed out in his “Money In Motion” report dated September 19, 2011 “there have been only two other times when the S&P 500 has dropped as much as 19-20% in roughly a two-week period: 1) the Crash of October 1987 (Oct.5-20) and 2) the *Lehman/Financial Crisis* of October 2008 (Sep 26-Oct 10).

But should long term investors throw in the towel now (the fact that many did on August 9th makes me think that we may have already seen a market bottom)? Is the Wall Street Journal right? I don't think so. We've been here before. Approximately a year ago, in fact. Some of the numerous "macro" headwinds the market faces are the same (European debt crisis), some are new (Mideast uprisings, Chinese growth engine slowing, "Brinkmanship" in Washington). Yet we have a lot of history on our side that indicates that the stock market has the ability to grapple with and eventually get through any development that it encounters no matter what it is. The history of the stock market to date is that the declines tend to be temporary – the market in all previous cycles has eventually recovered and exceeded its prior high. Some times it takes awhile, but it has gotten there. Investing in the stocks of global companies that are currently "on sale", but have plenty of cash, continue to be well-positioned for future growth and provide a positive current real return in the form of cash dividends, seems to me to be the best way to invest while you wait for the market to recover. Particularly when it's unpopular to do so.

Would you really prefer to be invested entirely in cash and/or fixed income securities? Moving to cash, while a useful short term planning tool, is not a rational long term investment policy given the negative real return on money market assets currently. Investment Grade bonds, which are benchmarked to U.S. Treasury rates, provide low current returns and are subject to considerable interest rate risk if Treasury rates do eventually rise from their current near all-time low levels. Non-Investment Grade bonds do provide higher current returns, but are subject to credit risk and need close monitoring, particularly in a "slow growth/no growth" economic environment.

So go against the crowd. Hold on to your stocks. If you don't own any, be a contrarian and take a small position in the stock of a couple of your favorite companies. Make sure that the stocks you pick pay a dividend and that the dividend can be sustained, if not increased. That way, you'll get a current return on your investment while you wait for the stock market to recover. Talk to you soon.

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