Bad News, Good News, Great News

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11:30 AM: SPX @ 2375; DJIA @ 22,015

As I pen this on Christmas Eve, the stock market has gone from all-time highs in September to ***OUCH*** in just three months. The S&P 500 has fallen 19% and is now -11% for the year. Even worse are small caps (Russell 2000), which are down 25% from their peak and international stocks (EAFE) which are down 16% YTD. Ouch, indeed! The decline that was painful in October has picked up speed in December with forced selling by hedge funds and mutual funds resulting in indiscriminate selling with no buyers to step in. This "selling into a vacuum" has fed on itself and investors' worst enemy - *emotions* - have ruled the day for the short term and it is painful! Yes, there are real problems - trade wars, rising interest rates, political dysfunction, etc., BUT there is also good news for those with clear enough heads to hear it. Here are a few things to keep in mind:

1. The economy is still growing - maybe not as fast as a few months ago, but growing. A recession is when the economy stops growing and moves backward. We are not there. At this time, I do not see a recession on the horizon in 2019.
2. Unemployment is still at the lowest level in 50+ years. More people are working and have money in their pockets than ever before. This is a good thing.
3. Corporate earnings could not possibly sustain their recent 20+% increases but they are still growing, not declining. This is also a good thing.

For over 32 years, I have been helping investors with their portfolios. Some of you have been with me that entire time or most of it. Here are some things I've learned from my years of doing this:

1. Being a one-year investor is a recipe for heartburn and disappointment. According to JP Morgan, since 1950 any given year in the stock market could have resulted in as much as a 47% gain or a 39% loss. However, when one considers every rolling 5-year period during these last 68 years, the

worst an investor would have done is lose 3% per year (or made as much as 28% per year!). **Always be (at least) a five-year investor.**

2. Markets fall faster than they rise because fear is a stronger emotion than greed. Sharp declines are never fun but they have happened before and will happen again.
3. Not every bear market looks like the last two (2000-2002 and 2007-2009) but that's what folks think about today. Instead, consider the fact that, during my first 14 years, I saw **three** bear markets that were sharp, short and had much quicker recoveries (average of 9.3 months). Market declines go with the territory - and they're never "just like last time." Eventually fundamentals like the economy and earnings rule the day - in the long run. That's how I came to "Herb's Three Rules for Equity Investing:" Own *quality, be diversified, invest in patience.*

Additional good news is that, even with the sharp declines of the last few months, the last few years have been rewarding. The S&P 500 has still averaged 8.3% per year over the past three years, and 8.1% over the past five. Having/keeping a proper time horizon is essential to successful investing. In his famous poem "IF," Rudyard Kipling starts out "If you can keep your head when all around you are losing theirs..." I think he would have made a great investor! Keep in mind the good news that does exist out there - including that stocks are much cheaper now than anytime within the past year.

As for the "great news" referenced in the title to this letter, I can't end this Christmas Eve letter without mentioning the great news celebrated this time of year - of a baby born in Bethlehem who would change the world forever. **Yes**, may we have "peace on earth, good will toward men." Truly the greatest news of all!