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What's Next for Equity Investors?

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Two things are top of mind for equity investors; a market downturn due to a recession or a market downturn due to excessive valuations.

I wouldn't lose sleep wondering if a recession will happen sometime in the future; it will since recessions are a natural part of the business cycle. However, we don't know when. It's important to keep in mind that the long term returns for the market of 8-9% include the periods of recession. In other words, you don't have to thread the needle and hold cash during every recession to generate attractive long- term returns.

Maybe more importantly, the long term returns for the average investor significantly trail market returns according to Dalbar and Associates. For the 30 year period ended 2016, they found that the average equity investor earned an annual return of 3.98% versus the 10.16% return for the S&P 500 and for the 20 year period ended the same year, the average equity investor return was 4.79% versus 7.68% for the S&P 500, both implying that the average investor is not very good at timing markets.

There have been three recessions since 1990 as outlined below.(1)

From July 1990-March 1991, the economy suffered a peak to trough downturn of -1.4% and had a modest twelve month trailing P/E of 15.31(2) at the beginning of the period (January 1, 1990). For the 1990- 1991 period, the S & P 500 generated a cumulative gain of 28%.

From March 2001- November 2001, the economy suffered a mild recession of -.3% caused by 9/11 and had a P/E ratio for the trailing twelve months of 27.55% on January 1, 2001. This recession coincided with the collapse of the dot-com

bubble which had led to abnormally strong annual returns for the S&P 500 from 1995-1999. The combination of excessive valuations and a mild recession led to a large cumulative loss from 2000-2002 of 43%.

From Dec 2007 through June 2009 during the credit crisis, the economy suffered a severe downturn of 5.1% and began 2008 with a trailing twelve month PE ratio of 17.36. The cumulative loss for 2008-2009 was 15%. According to Yardeni Research, the trailing twelve month P/E ratio for the S&P 500 using reported earnings was 19.7, a level that we think implies an environment where active value managers could provide downside protection.

As active managers, we thought it would be interesting to review how much downside protection active managers provided during these periods, particularly value-oriented managers.

	1990-1991	2000-2002	2008-2009
Cumulative S&P 500	+28%	-43%	-13%
Cumulative Large Cap Growth(3)	+38%	-71%	-2%
Cumulative Large Cap Value(3)	+21.5%	-20%	-15%
Our Core Equity Composite(4)	NA	+13.2%	+6.1%

(3)Large Cap Growth and Large Cap Value returns per Fidelity.com represent the average of The Russell 1000 Growth Index and the Lipper Index of Large Cap Growth Funds and the average of the Russell 1000 value Index and the average of the Lipper Large Cap Value Index respectively.

(4)The inception date of our Core Equity Composite is December 31, 1991.

We draw some general but not conclusive insights from these tables. Active management seems to provide little downside protection from recessions. However, recessions have historically represented less risk to investors than high valuations and active value managers did provide significant downside protection in the 2000-2002 downturn, the most significant downturn since 1990 by far.

More information as to why we think our approach has provided strong downside protection to clients is available on our website.

(1)Wikipedia is the source of the timing and extent of the three recessions since 1990
(2)All trailing twelve month P/E ratios are sourced from Robert Shiller's book "Irrational Exuberance"

Mr. Nowell has over thirty years of experience in the finance business. Prior to founding South Atlantic Capital he worked in the leveraged lending department of Bankers Trust Company, New York as an Assistant Vice President. His primary responsibility was arranging bank financing for leveraged buyouts led by

Kohlberg, Kravis, Roberts & Company. During graduate school he interned with Merrill Lynch's Capital Markets Group in New York. Later he served as an institutional fixed income salesman for Carolina Securities/Prudential Bache Securities and worked with Fox, Graham, and Mintz Securities. Mr. Nowell graduated from the University of North Carolina with a B. S. in Economics and received his MBA from the University of Virginia.

Past performance is not indicative of future results.