AFTER A MARKET CRASH

HOW FAR CAN IT GO?

JOHANNESBURG: One of the questions investors are asking most frequently is how long the stock market can continue to grow after the crash of 2008/9. Some people are concerned that our stock market cannot increase continuously and perhaps it may drop back the low levels seen in March 2009. As with all questions relating to investments, it is impossible to make any concrete predictions but we can look at the past as an indicator of possible outcomes. I usually disregard short historical periods but longer long periods (20 years or more) can provide some useful guidelines for the future. Anil Jugmohan from Nedgroup Investments did some great analysis of post bear market returns of the JSE. He analysed all the crashes from 1900 to date where the market fell by 20% or more – the results of which provide some very interesting insights into the length and strength of a stock market recovery after a crash.

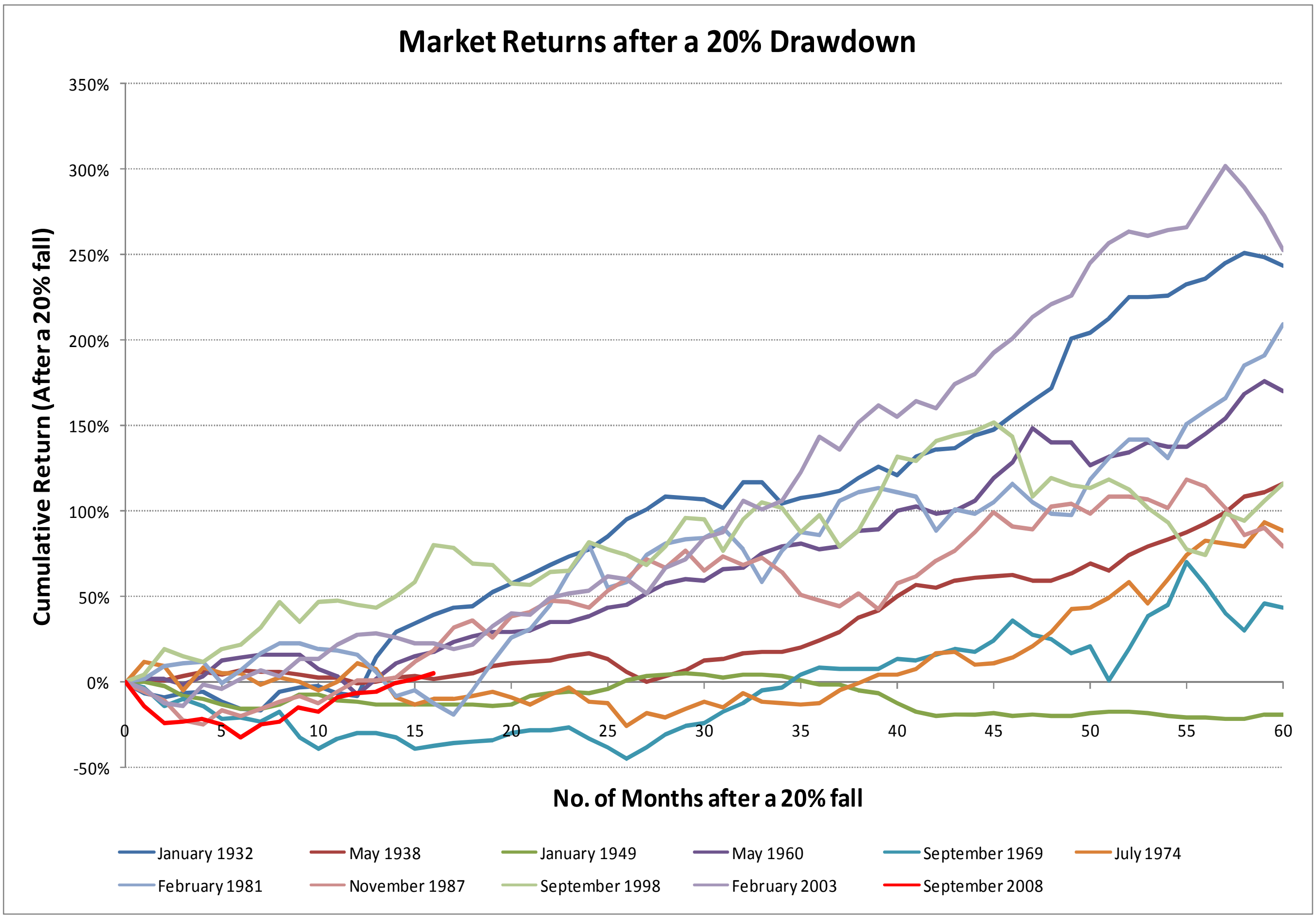
TWO CATEGORIES OF RECOVERY

Stock market recoveries are obviously never identical however there are two broad groupings of recoveries that are distinguishable by the length of time they took to recover all their losses. These can be divided into two and four year recoveries. This means they took 2 or 4 years to get back to their peak pre-crash levels. Our market reached its peak in May 2008 so we are still a few months short of the two year mark and we are still below our pre-crash levels. The recoveries that took four years or longer were all pre-1980 whilst the quicker recoveries have mostly been more recent i.e. after 1980. If you were to graph these categories of recoveries, the quicker ones look like the letter “V” whilst the slower recoveries look more like the letter “U”. None of the recoveries took place without hiccups as all of them recovered, fell and recovered again - sometimes repeatedly. The current recovery seems no different.

WHAT CAN WE LEARN FROM ALL OF THIS?

All stock market recoveries are unpredictable. Just like the crashes that precede them, we cannot be sure of how they will turn out. Currently, many commentators are saying that our market is starting to look expensive and is probably due for a fall now. History tells us that one needs to balance this view with a broader perspective. The graph below shows that our market recovery is still in its early stages. The graphs show the market performance from the point of a 20% loss i.e. not from pre-crash market highs. When compared to all the other big crashes of 20% or more, the current recovery (red line) can still carry on much longer and it can move much higher.

If you were a blind follower of historical trends, you would be betting that it can double its value from here. This is not a prediction that the recovery will continue for the next few years but it does suggest you would be foolish to bet farm on another major correction.



Source: I-Net, compiled by Nedgroup Investments

It is likely that the international markets will determine how our market will perform this year. If the international markets have a bumper year, we are most likely to see great growth too. If the international markets stay flat or drop, we could see a fall but perhaps not on the same scale as we have seen in 2008/9.