MarketWatch

The best strategy to recover from a stock-market bottom is one you already know

By Philip van Doorn
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Ten years from the post-crisis stock-market bottom, three money managers share their experiences

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As we approach the 10-year anniversary of the post-crisis stock-market bottom on March 9, 2009, three money managers have shared the stories of how they and their clients navigated a dangerous financial environment and the lessons all investors can learn from history.

Ten years can soothe memories. For some younger investors, the mortgage-credit crisis, stock-market bloodbath and eventual rebound might seem irrelevant, or even ancient history. The circumstances around the next major stock-market decline will be different, of course, but human psychology will no doubt be similar to what drove many investors in 2008 and early 2009 to act against their own long-term interests.

> 'The longer you wait for things to seem safe, the closer you are to the day before Thanksgiving, if you're a turkey.'
>
> *Charles Lemonides, chief investment officer of ValueWorks in New York*

All three managers emphasized the importance of maintaining discipline through a crisis and, rather than running away from the market, staying in and even taking advantage of price declines to improve your portfolio to take better

advantage of the inevitable recovery.

Top-down perspective

Let's start with four charts. Here's how the S&P 500 Index and Dow Jones Industrial Average performed as the subprime-mortgage bubble burst, from the end of 2007 through the bottom on March 9, 2009:

Those are total return figures, which include reinvested dividends. You can see the worst of the decline began in September 2008, which is when Lehman Brothers went bankrupt, Washington Mutual failed (with the wreckage purchased from the FDIC by J.P. Morgan Chase JPM, -0.51%) and Merrill Lynch was acquired by Bank of America BAC, +0.05% Then President George W. Bush signed the Troubled Asset Relief Program, or TARP (otherwise known as the bank bailout), on Oct. 3, 2008.

Here are the indexes' total returns from the end of 2007 through the end of 2011:

You can see that in early May 2011, the indexes were close to returning to the break-even point, before pulling back.

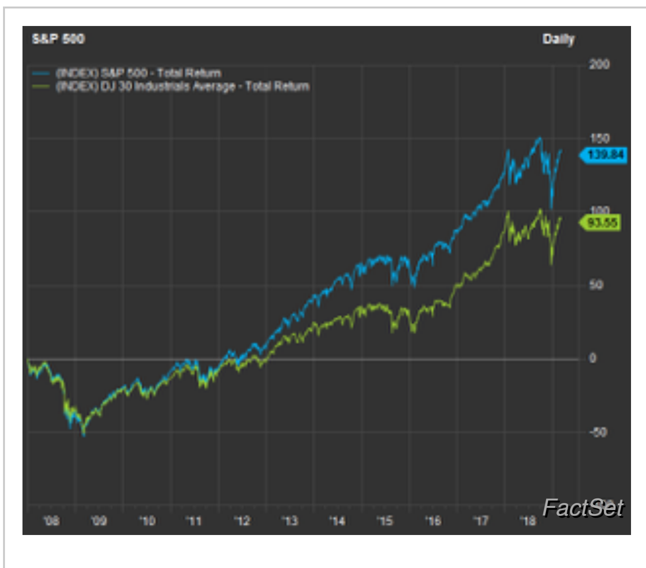
Here are total returns from the end of 2007 through March 6, 2019:

One can argue that the above chart provides a more realistic picture of the market than the following chart, from the bottom on March 9, 2009, through March 6, 2019:

That last chart shows a return of over 400% for the S&P 500 from the bottom through March 6. But you can see in the third chart how important it is to take a long-term return from a generational market bottom with a grain of salt. Since we're 10 years out from the bottom, you will be impressed with the 10-year return figures for most stock mutual funds.

Capitalizing on a bad situation

Charles Lemonides is the chief investment officer of ValueWorks, which is based in New York and has about $200



million in assets under management. He said the financial crisis was “so dramatic it caught everyone’s attention.”

“People who had a significant net worth had a significantly different net worth in a moment in time,” he said.

Charles Lemonides, chief investment officer of ValueWorks in New York.

Even the most reasonable person can panic during a sustained stock-market decline.

Thyra Zerhusen is the chief executive officer and chief investment officer for Fairpointe Capital, which is based in Chicago and has about $3 billion in assets under management, including the AMG Managers Fairpointe Mid-Cap Fund ABMIX, +1.37% and the AMG Managers Fairpointe ESG Equity Fund AFFEX, +1.24% She said that in October 2008, she met with a large institutional client’s investment committee and was “almost fired” after Fairpointe had served the client since 2001.

But the client decided not to pull the plug. “I had another meeting with that foundation probably in January 2010, and that time the equity of that foundation was up 70% for the full year in 2009,” she said. “We had bought some stuff when we were really down and out.” Taking advantage of low prices was an important part of Zerhusen’s strategy.

> ‘Control your emotions. Sometimes do the opposite of what your emotions tell you to do. When everything is down, put some money to work. When things are great, take some money off.’

Thyra Zerhusen, chief investment officer of Fairpointe Capital in Chicago

“The biggest shock was how fast it all played out. It felt like forever as it was happening. But the heart of the downturn was a lousy four months,” Lemonides said.

“A year and a half later, so much of the damage was behind us,” he said. “As we hit new lows, the commentary was it would take years and years.”

David Marcus is the CEO and chief investment officer of Evermore Global Advisors of Summit, N.J., which has about $1.1 billion in assets under management, including the Evermore Global Value Fund EVGBX, +1.13%

"It is so important to be communicating with your investors, especially during tough times," Marcus said. "I am not calling when we have a great run to pat myself on the back, but I am calling after we've had a tough run so that investors understand what caused it, what we're doing with their capital and how we're invested going forward."

David Marcus, chief investment officer of Evermore Global Advisors in Summit, N.J.

Fast-forward to the fourth quarter of 2018, when the S&P 500 was down 13.5% (with dividends reinvested), and Marcus was calling clients again. "I said I wanted to meet with them and tell them what we had, why we owned it and why they should consider adding more money to invest with us," he said.

"The reaction is no different now than it was 10 years ago. Generally investors are surprised to get this type of call," Marcus added.

'My view has always been that you have to buy things when people hate them.'

David Marcus, chief investing officer of Evermore Global Advisors of Summit, N.J.

Like Zerhusen and Marcus, Lemonides stressed the importance of not running away and "improving your holdings" by taking advantage of opportunities to buy shares of high-quality companies during periods of turmoil.

"People got out on the way down, and many have never gotten back in," he said. He went on to say that some investors continued to believe stock prices were too high, and remain "underinvested" in stocks to this day. "Now is as a good a time as any to buy an asset you want to own for the next five or 10 years."

Lemonides said he began to feel comfortable that the worst of the crisis was over when the Obama administration made it clear that "bank preferred stocks that were outstanding at the time were going to be protected and that they weren't going to force investors to take further losses."

Zerhusen said that rather than regaining confidence in the market as a whole, she went "stock by stock." Getting back to that painful conversation with a client in October 2008, she said that when the client asked what she was doing, she said she was doing "what I always do, adding to selected stocks where I have confidence."

Government support

Lemonides and Marcus discussed examples of investment opportunities brought about by the financial crisis, not only during the decline leading into the bottom, but afterward as well.

Lemonides said he sold Freddie Mac FMCC, -1.18% common shares at $1.22 on Sep. 23, 2008, after the Treasury Department took the government sponsored enterprise (GSE) and its sister mortgage giant Fannie Mae FNMA, -1.32% under conservatorship. Both GSEs' preferred-stock dividends were suspended. But on the same day he sold the common shares, Lemonides began purchasing Freddie Mac series V preferred stock FMCKM, -1.31% for 72 cents a share. Those shares have a $25 par value. They are now trading for about $7.70.

Thyra Zerhusen, chief investment officer of Fairpointe Capital in Chicago.

Lemonides said that "one of the last things" he purchased before the market bottomed was Eli Lilly LLY, +0.15% at about $32 a share, which he sold "within the last week at $128."

When TARP was passed, the Treasury provided most bailout money to banks by purchasing preferred shares from them, while also receiving warrants (a security allowing the bearer to buy shares of a company at a fixed price until an expiration date).

In October 2008, executives of some of the large banks that took TARP money said they were pressured by Treasury Secretary Henry Paulson to do so. "The government basically determined the only way to avoid having a 'bad bank list' was to give money to banks that didn't need it," Marcus said.

So he saw an investment opportunity when the government started to sell its warrants in the open market. "We didn't need to bet on earnings. The only question was whether or not we thought the financial system would continue to exist," Marcus said.

The answer to that question was obviously "yes," so in late 2009 Marcus decided to buy warrants in J.P. Morgan Chase, Bank of America, Hartford Financial Services HIG, +0.46% and Capital One COF, -0.02%

"Those were some of the best investments we ever made," he said.

When asked if he would have simply purchased bank stocks in 2009 if the warrants had not been available, Marcus said "yes." "Our conclusion was that the reasonably capitalized banks would survive."

"Fear, panic and crises create investment opportunities. We are not wishing for fear and panic, but we can take advantage of the opportunities when other people go into extreme panic mode," he said.

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