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STRATEGIES

25 Years to Bounce Back? Try 4½

By MARK HULBERT

HISTORICAL stock charts seem to show that it took more than 25 years for the market to recover from the 1929 crash — a dismal statistic that has been brought to investors' attention many times in the current downturn.

But a careful analysis of the record shows that the picture is more complex and, ultimately, far less daunting: An investor who invested a lump sum in the average stock at the market's 1929 high would have been back to a break-even by late 1936 — less than four and a half years after the mid-1932 market low.

How can this be? Three factors have obscured this truth from investors: deflation, dividends and the distinction between the Dow Jones industrial average and the overall stock market. Let's consider them one by one:

DEFLATION The numbers show that from a peak, on a closing basis, of 381.17 on Sept. 3, 1929, the Dow needed until Nov. 23, 1954, to return to its old high. But that's in "nominal" terms, without adjusting for the effects of inflation or its opposite, deflation.

The Great Depression was a deflationary period. And because the Consumer Price Index in late 1936 was more than 18 percent lower than it was in the fall of 1929, stating market returns without accounting for deflation exaggerates the decline.

DIVIDENDS These payouts played a big role in the 1930s. When the Dow hit a low of 41.22 on July 8, 1932, for example, the dividend yield of the overall stock market was close to 14 percent, according to data compiled by Robert J. Shiller, the Yale economics professor.

So ignoring dividends, especially when yields were so rich, also exaggerates the losses of a typical equity investor.

THE DOW VS. THE MARKET Many researchers consider the overall market — defined as the combined value of all publicly traded stocks — as the best gauge of a typical investor's experience. The Dow is made up of just 30 stocks, which are weighted in the index according to their price rather than their relative market capitalization.

Perhaps the most celebrated illustration of the Dow's failure to represent the overall market traces back to a 1939 decision to delete International Business Machines from the Dow 30 list. I.B.M. wasn't restored to the index until 1979. Norman Fosback, editor of Fosback's Fund Forecaster newsletter, has estimated that the Dow would have been more than twice as high in 1979 had I.B.M. stayed in the index continuously.

It’s unclear when the Dow would have returned to its 1929 pre-crash high had I.B.M. not been deleted in 1939. In response to a request, an analyst at the indexes division of Dow Jones said that it was unable to determine the answer. But because I.B.M.’s stock was one of the best performers during the 1940s, greatly outpacing the Dow itself, it’s certain that its inclusion would have markedly accelerated the index’s recovery.

So when did the overall stock market really make it back to its pre-crash peak? Just four years and five months after its mid-1932 low, according to data provided to Sunday Business by Ibbotson Associates, a division of Morningstar.

That seems remarkably fast, given that the stock market lost more than 80 percent of its value from its 1929 high to its mid-1932 low.

But the quick recovery of the 1930s is consistent with the typical experience after other bear markets in the United States.

DETERMINING the precise length of such recoveries is a problem, given the many definitions of a bear market. Whatever definition is used, however, the typical recovery time is quite quick.

In fact, according to a Hulbert Financial Digest study of down markets since 1900, the average recovery time is just over two years, when factors like inflation and dividends are taken into account. The longest was the recovery from the December 1974 low; it took more than eight years for the market to return to its previous peak, which was reached in late 1972.

None of this, of course, guarantees that stocks will have a quick recovery from the market decline that began in October 2007. But it suggests that the historical record isn’t as bleak as it looks.

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