"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves." **-- Peter Lynch**

There has been much ballyhoo in the press recently about the coming equity market correction. Accordingly, some investors choose to sit on the sidelines waiting patiently for the inevitable. We purposely use the term "inevitable" since price declines are simply part of long-term investing in stocks.

A price decline of about 10% in the market is considered to be a "correction". That's very different than a "bear market", where a steady decline in prices results in an overall drop of 20% or more. Despite numerous pullbacks over the past five decades, investors who have "stayed the course" have come out ahead in virtually all cases. The data we've put together on the S&P500 Index to illustrate this is as follows:

Period	10 - 20% Corrections	>20% Bear	Period Price Return (%)
1950 - 1960	6	1	131.8
1960 - 1970	4	2	50.86
1970 - 1980	5	2	25.18
1980 - 1990	2	1	133.69
1990 - 2000	5	1	152.51
2000 - 2010	3	2	-2.93
2010 - Current	3	1	64.66

In the roughly four and a half year period since December 31, 2009, the market has undergone three "corrections" where prices have fallen at least 10%, and one where prices fell more than 20% (classically defined as a "bear" market) – yet the market has risen almost 65% during the period despite these pullbacks!

We use the S&P500 Index for this illustration as it is a better diversified market than the Canadian indices, which are too heavily influenced by commodity-based exploration companies like oil, gold, and base metal stocks. A decline in the underlying commodity can produce headwinds for the overall market that are not indicative of underlying Canadian companies.

To go one step further, we measured the impact the last recession would have had on our current portfolio (for these purposes, we equally weighted the holdings and assumed no cash was held). During the major pullback between June 30, 2008 and February 29, 2009, the S&P500 fell 42.6% while our holdings fell 38.2% – a modest outperformance, but still a substantial decline (we believe performance would have been significantly improved by our optimization process). However, for the balance of 2009, our hypothetically weighted portfolio rose 108.4% compared to the 51.7% increase of the S&P500. These are price returns only – we've assumed the dividend yield on both the market and our portfolio was constant.

One could argue that exiting at a market peak and re-entering at roughly a market bottom (better known as market timing) would protect the underlying capital and improve overall return. We can't argue with that logic. However, market timing requires two decisions – when to get out and when to get back in. If we simply look at the period from the absolute top of the S&P500 on October 9, 2007 to the absolute bottom on March 9, 2009 there were no fewer than five false signals that the carnage had ceased and it was safe to reinvest.

In short, the most important factor in stock investing is time. When analyzing investments, we look at the potential return over the next five years and not five quarters. Over any short term period, markets get fearful about a variety of events – interest rates, economic growth, geopolitical risks, inflation/deflation, etc. – which can result in some price pullback. There are certainly times when these issues can come to bear, but usually the market eventually shrugs them off. Knowing our investments well, we view market fear as an opportunity.

Prognosticators abound but, in our experience, few have been right more than once. We prefer to take solace in the strength of our underlying businesses and their experienced management teams.