



## Helping You Navigate Turbulent Times Issue 25/15 for June 23, 2015



**CONTRARY TO POPULAR BELIEF, A CRISIS DOES NOT USUALLY CAUSE A MAJOR PROBLEM FOR THE ECONOMY OR MARKETS.**

Last week's Update was entitled "Do Rising Interest Rates Really Matter." I pointed out that higher interest rates on their own, are not usually negative for the markets. I also said, "...conditions may change enough by September that a rate increase may not be warranted anymore..." After writing that Tuesday evening and having it approved Wednesday morning, it was emailed to you 30 minutes before the Fed announcement came out at 11:15 am Pacific Time. Interestingly, the announcement changed peoples view so that the percentage of investors expecting the Fed to raise interest rates in September has now declined from 60% to 40%. You heard it hear first.

The other major topic dominating the business headlines has been the deplorable debt situation in Greece. Greek leaders and the ECB have been playing a game of chicken for months now as debt repayment deadlines are approaching within days. English writer, Samuel Johnson (1791) wrote, "When a man knows he is going to be hanged in a fortnight, it concentrates the mind wonderfully." The deadline Greece has with the ECB and the IMF to decide whether or not they remain in the Euro has a similar affect. It seems like Greece has blinked by willing to offer some concessions that were not on the table before. All sides now seem more optimistic and history suggests there should be some sort of compromise at the last minute. Nevertheless, there is still no assurance that a deal will be reached. What will be the consequences if Greece defaults on its debt and leaves the Eurozone?

If we take the time to look back at history, we can see how human beings/investors have responded to similar crises in the past. Fairly recent events like the September 11, 2001 terrorist attacks and the 2008 Financial Crisis make it appear as though a crisis or unexpected event causes major havoc in the economy and the markets, but history actually presents a different verdict. On the following page, I have noted many of the major crisis or unexpected events since 1941, and have separated the events where the DJIA was up after 12 months from the incidents when the Dow Jones Industrial Average was down after 12 months.

## Dow Jones Industrial Average Returns Following Crisis Events

### Events When DJIA Was UP 12 Months After a Crisis

		3 Months	12 Months
Japanese bomb Pearl Harbor (Almost a gain for such a major event)	Dec 8, 1941	-9.8%	-0.8%
Hiroshima bomb	Aug 6, 1945	15.7%	24.4%
U-2 shot down - U.S. admits spying	May 9, 1960	1.1%	21.1%
Cuban Missile Crisis starts	Oct 23, 1962	18.8%	31.4%
Kennedy assassinated	Nov 22, 1963	8.8%	21.6%
Nixon imposes price controls	Aug 16, 1971	-5.0%	12.6%
Chernobyl nuclear meltdown	Apr 29, 1986	-3.8%	21.1%
1987 Stock Market Crash	Oct 19, 1987	10.2%	22.9%
Coalition bombing of Iraq	Jan 17, 1991	19.1%	29.5%
British Sterling Crisis	Sep 16, 1992	-1.3%	9.2%
U.S. Marines killed in Somalia	Oct 4, 1993	4.8%	7.3%
Fall of Mexican peso	Dec 20, 1994	7.5%	34.8%
Oklahoma City bombing	Apr 19, 1995	21.1%	32.8%
Asian Crisis begins	Jul 2, 1997	3.8%	17.2%
Clinton/Lewinsky made public	Jan 21, 1998	16.1%	18.6%
Long Term Capital bailout	Sep 23, 1998	14.5%	33.3%
Clinton impeached	Dec 19, 1998	11.2%	25.2%
Space shuttle Columbia explodes	Feb 1, 2003	4.2%	29.5%
U.S. invades Iraq	Mar 20, 2003	11.0%	21.4%

SARS virus health scare	Mar 2003	12.8%	35.3%
Hurricane Katrina floods	Aug 29, 2005	4.1%	8.8%
Fukushima nuclear meltdown	Mar 11, 2011	-0.7%	9.5%
U.S. debt ceiling dispute	Jul 25, 2011	-7.0%	3.8%
Eurozone Debt Crisis	Aug 2011	3.9%	6.9%
U.S. Fiscal Cliff Crisis	Nov 2012	5.9%	18.0%
U.S. Gov't shutdown	Oct 1, 2013	8.2%	??

#### Events When DJIA Was **DOWN** 12 Months After a Crisis

Watergate news reaches Senate	Jun 25, 1973	5.5%	-7.3%
U.S. V.P. Spiro Agnew resigns	Oct 10, 1973	-14.3%	-35.2%
Reagan shot	Mar 30, 1981	-0.2%	-17.8%
U.S. Marines killed in Lebanon	Oct 24, 1983	0.8%	-1.8%
U.S. invades Grenada	Oct 25, 1983	-0.5%	-2.6%
Fall of Berlin Wall	Nov 9, 1989	0.8%	-6.8%
Y2K	Dec 31, 1999	-11.9%	-6.2%
Bombing of USS Cole	Oct 12, 2000	4.9%	-6.8%
World Trade Towers destroyed	Sep 11, 2001	2.9%	-10.7%
Bear Stearns fails	Mar 14, 2008	3.0%	-39.6%
Lehman Brothers fails	Sep 15, 2008	-21.5%	-11.3%

While some may debate what is included and excluded, there are 26 incidents when the DJIA rose after 12 months compared to 11 when the DJIA declined.

Why did stocks rise after many unexpected events and decline after others? Why did equities fall 9.8% after the Berlin Wall came down in 1989, which was a positive event, yet rise 21.1% after the Chernobyl nuclear meltdown? Let me answer that with a comment that may seem like a broken record. It is profound nevertheless.

The U.S. yield curve inverted in 1989 when the Berlin Wall came down, resulting in a U.S. recession, which dragged down the DJIA. Why did the DJIA fall 17.8% after President Reagan was shot and slightly wounded in 1981, yet rise 21.6% after President Kennedy was assassinated in 1963? Because the yield curve inverted and oil prices had increased by 80% in 12 months by early 1981.

Why did the DJIA fall 35.2% when U.S. Vice President Spiro Agnew resigned due to the Watergate Scandal in 1973, yet rise 18.6% after President Clinton was going to be impeached in 1998? Oil prices rose more than 80% in 12 months in 1973.

Why did the value of the DJIA increase by 33.3% after the Long Term Capital Hedge Fund was bailed out in 1998 and fall 39.6% after Bear Stearns failed and the U.S. government arranged a take over in 2008? The yield curve inverted in July 2006 and oil prices rose 80% in 12 months as of April 2008.

History seems to point out something we find hard to accept. In many cases a crisis is not that negative for the economy or the markets. When we think of the uncertainty regarding Greece, it is interesting to look back and see that the DJIA rose 9.2% in the year after the British Sterling fell in 1992. U.S. stocks rose 34.8% after the Mexican Peso hit an air pocket in 1994 and 17.2% 12 months after several Asian currencies collapsed in 1997.

Russia defaulted on its debt in 1998, which was a surprise. Yet the DJIA was up close to 30% 12 months later. History shows that markets and economies can handle a crisis or unexpected event most of the time, just like the human body can handle all the viruses that are floating around us all the time. However, when the markets and the economy are under severe stress due to an inverted yield curve and/or a big spike in oil prices, they are likely to suffer. If a crisis occurs at a time like that, it will usually just shorten the time before the suffering and pain occurs. The same thing happens in our bodies. If we are stressed out, tired, not eating well and not exercising, viruses are much more likely to take hold and make us sick.

In conclusion, whatever happens with Greece should not cause a major long-term problem with global economies and markets since the yield curve is not inverted and oil prices are much lower than they were a year ago.

FYI, Zimbabwe was once the breadbasket of Africa. While taking property from the landowners and giving it to the locals may have seemed like a good idea at the time, it has turned into a colossal disaster. Imagine inflation reached 1,000,000% so that a loaf of bread cost Z\$1,000,000 one year and 1 million times that the next! There is no word to describe \$1,000,000,000,000. Unemployment is now at 80%. What a disgrace! That is why this boy is not being mugged and robbed.



Like President Robert Mugabe in Zimbabwe, Hugo Chavez became a folk hero for distributing wealth in Venezuela. Now annual inflation has reached 510% there. These experiments work for a short time, but not a long time before there is much more misery and personal suffering than there was before.



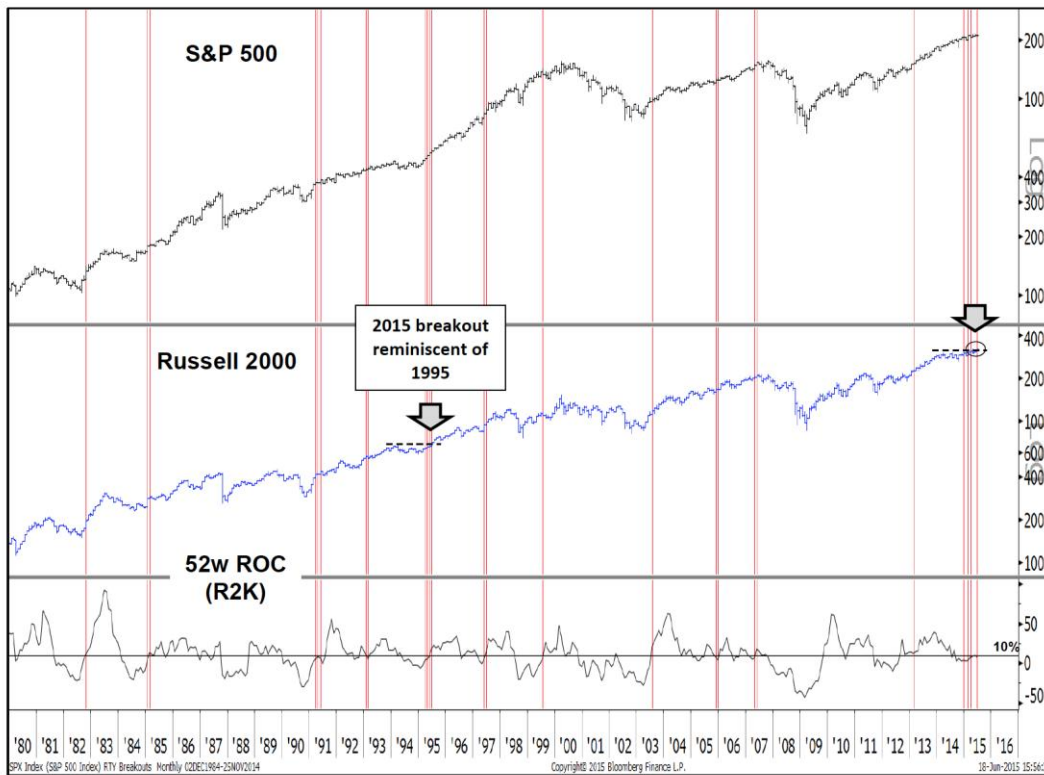
On a lighter note, monster truck Max D has been the first to successfully perform a double back flip last weekend. What some people are able to do these days is utterly amazing. The bar is being raised in many ways in some countries.

## Crisis Events

DATE(S)	WAR/POLITICAL EVENT	S&P 500 Gain/Loss			
		1mo	3mos	6mos	12mos
03/20/2003	U.S. Launches Operation Iraqi Freedom	-2.2%	13.9%	18.6%	27.0%
09/11/2001	Terrorist Attack on U.S.	0.4	4.0	6.9	-16.8
01/17/1991	U.S. Launches Operation Desert Storm	16.7	23.5	20.6	32.5
08/02/1990	Iraq Invasion of Kuwait	-9.3	-12.3	-3.5	8.9
04/15/1986	U.S. Bombs Libya	-1.2	-1.5	0.6	19.9
06/05-06/10/1967	6-day Middle East War	1.7	4.9	6.1	11.2
11/22/1963	Kennedy Assassination	3.7	8.4	12.7	20.5
10/14-10/28/1962	Cuban Missile Crisis	5.6	14.5	20.8	27.0
06/25/1950	Korean War	-4.6	5.7	10.0	17.6
12/07/1941	Pearl Harbor	-4.1	-12.3	-10.4	-0.9
05/10/1940	Invasion of France	-25.8	-14.5	-5.9	-20.9

InvesTech Research

Regarding market reactions to a crisis, here is a table from InvesTech Research showing the reactions to a war or political event. The yield curve inverted in July 2000 and oil was up 80% in 12 months in 1999, which is why markets declined 16.8% after September 2001. This was the only 12-month decline since 1941.



**S&P 500 Forward Performance when:  
\*Russell 2000 AT a 52w High, and...  
\*Russell 2000 52w Rate of Change < 10%**

Date	4w	13w	26w	52w
15-Oct-82	4.5%	9.8%	18.9%	27.2%
25-Jan-85	1.1%	2.7%	8.5%	16.4%
1-Feb-85	2.6%	0.8%	7.2%	18.6%
29-Mar-91	1.0%	-1.1%	2.8%	7.5%
5-Apr-91	1.4%	-0.3%	1.6%	7.0%
12-Apr-91	-1.2%	0.0%	0.3%	6.3%
31-May-91	-4.8%	1.4%	-3.7%	6.5%
15-Jan-93	1.7%	2.7%	2.0%	8.6%
5-Feb-93	-0.6%	-1.5%	-0.1%	4.7%
31-Mar-95	2.8%	8.8%	16.7%	28.9%
14-Apr-95	3.2%	9.9%	14.8%	25.0%
28-Apr-95	1.7%	9.4%	12.6%	27.0%
12-May-95	0.5%	5.6%	12.8%	24.1%
19-May-95	4.0%	7.7%	15.6%	28.8%
26-May-95	5.0%	7.0%	14.6%	29.6%
2-Jun-95	2.3%	5.9%	14.0%	25.7%
9-Jun-95	5.4%	8.5%	17.0%	27.5%
23-May-97	6.1%	9.0%	13.7%	31.1%
30-May-97	4.6%	6.0%	12.6%	28.6%
6-Jun-97	6.9%	8.3%	14.7%	29.8%
16-Jul-99	-6.4%	-12.1%	3.3%	6.4%
4-Jul-03	-0.6%	4.5%	12.5%	14.2%
25-Nov-05	0.0%	1.7%	0.9%	10.5%
2-Dec-05	-1.3%	1.8%	1.8%	10.4%
20-Apr-07	2.6%	3.4%	1.1%	-6.3%
27-Apr-07	1.4%	-2.4%	2.8%	-6.4%
4-May-07	2.0%	-4.8%	0.3%	-6.1%
1-Feb-13	0.3%	6.7%	13.0%	17.8%
26-Dec-14	-1.8%	-1.3%	-	-
13-Feb-15	-2.1%	1.2%	-	-
20-Feb-15	-0.1%	0.7%	-	-
27-Feb-15	-2.1%	0.1%	-	-
20-Mar-15	-1.3%	-	-	-
19-Jun-15	-	-	-	-
<b>Average</b>	<b>1.1%</b>	<b>2.9%</b>	<b>7.9%</b>	<b>15.6%</b>
<b>All Periods</b>	<b>0.7%</b>	<b>2.4%</b>	<b>4.9%</b>	<b>10.0%</b>

Since 1979

Source: Oppenheimer Asset Management, and Bloomberg. Note: These results cannot and should not be viewed as an indicator of future performance.

This is a study of smaller companies (represented by the Russell 2000 Index) done by Oppenheimer on June 22, 2015. They looked at times when the Russell 2000 has broken out to new all-time highs when it was up less than 10% in the previous 52 weeks like it has now. They discovered when this has happened in the past, the S&P 500 has risen 7.9% in the following 6 months on average, as compared to the normal average of 4.9%. For the following 12 months, the S&P 500 has increased an average of 15% compared to the average 12-month gain of 10% for all periods. They point out that the current situation is similar to 1995.

Isn't that interesting. A number of previous Updates have pointed out that the average gain for the DJIA in a year ending in five is far above average. RBC Technical Analyst Robert Sluymer points out that the DJIA has been up 9 out of 10 times since 1905 (in years ending in five) with an average gain of 31%. The S&P 500 has been positive all 8 years ending in five since its inception with an average gain of 25%. If 2015 is going to follow that pattern, there are only six months left to produce the bulk of a 31% return for the DJIA. (It is almost flat so far this year.) It will be very interesting to see if this will repeat. The higher level of pessimism and fear in recent weeks has produced a healthier environment for stocks to rise. Have a great week!

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