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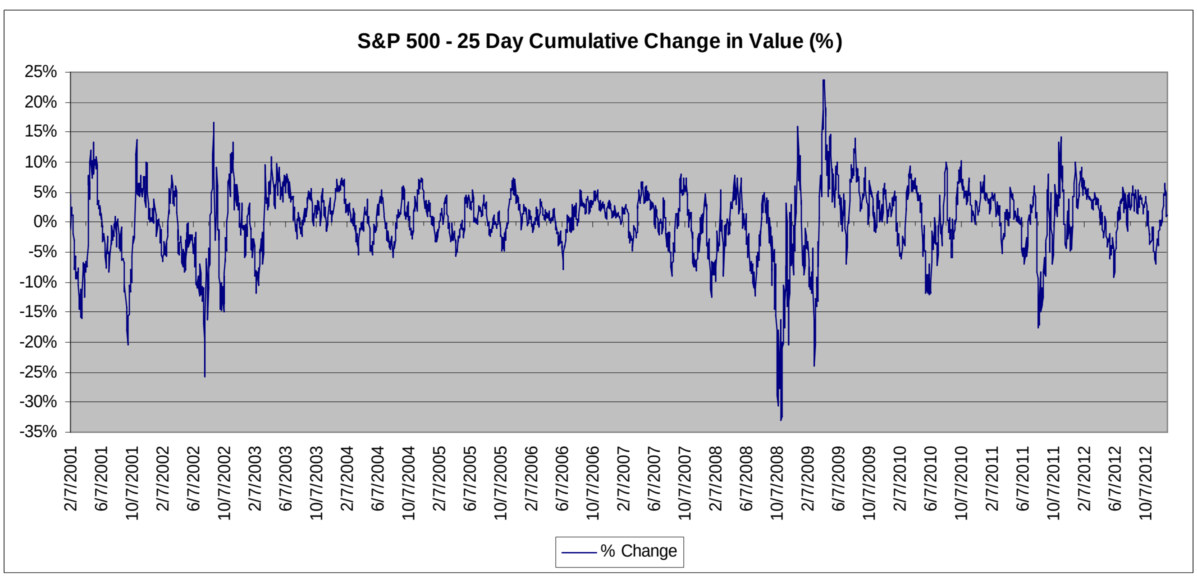
What's a reasonable market pullback?

The year of 2012 was a rather bullish year for the market. Throughout the entire year the market, defined by the S&P 500, never finished out the day below the level it began at during the beginning of the year. As we progress into 2013, it will be interesting to see how the market responds to future events.

Undoubtedly, the market will experience a pull-back during at least one point during the year. As an investor, what should be considered a substantial pull-back in the market? This question is important because it helps determine when general market conditions are ripe for placing buy orders.

To help determine a sense of what is a reasonable pull-back in the market, I looked at daily changes in market price at the close of the market for the S&P 500 from the start of 2001 until the end of 2012. The charted values below show the day-to-day change in the market's value over a cumulative 25 trading day period (5 weeks). A 5 week period was chosen because down-turns in the market are much swifter than increases. While market weakness can last over a period of months, the initial drop is usually more pronounced than the smaller and more methodical increases associated with a bull market.



(In my descriptive below, I am ignoring times of high volatility in the market, such as 08-09 and 01-02. These periods would not apply because they are periods of time when extremely high degrees of market volatility existed. Therefore, the regular rules and observations cannot be applied.)

To answer the question about what's a reasonable market pull-back, the data presented above can be looked at in two different ways. One way would be to consider a drop below the threshold of 0%. Once the market drops below 0%, the market is entering into a period where over the last 25 days it has produced a negative return. Under such parameters, a 5%-10% drop under 0% would constitute a sizable pull-back in the market.

Another way to evaluate the data would be to look at the difference between the proceeding high and subsequent low point. This can be visually seen on the chart by identifying the positive value peaks and then measuring the drop to the inverted peak's bottom.

A reduction in market value from high point to a low point of 10% is a strong indication of an opportunity to buy. A reduction of 15% or more should be considered as an extremely strong buy signal.

We've been in the midst of a bull market for over a year now. We've seen one decent pull-back in the spring and more recently a more moderate pull-back in the market. It's important to be patient when investing. Knowing what a reasonable decline is when it comes to the market can be a very good way to determine when and at what levels buying is appropriate.

Lastly, it should be noted that different industries and sectors may behave differently from the general market. If you're set on buying from a specific industry, it would be beneficial to perform the same analysis on an applicable industry index along with the market. This may highlight buy signals when the industry has seen a historical decline, which may not be reflected in the overall market.

TheMarketCapitalist.com Portfolio Selection

Company	Ticker	Buy Date	Buy Price	Last Price	Performance	Dividend %	Buy Target
SeaDrill Limited	SDRL	9/7/2011	30.25	37.80	24.96%	8.10%	Up to 38
Weatherford International Ltd.	WFT	9/7/2011	16.31	11.59	-28.94%	0.00%	Up to 26
American Tower Corp.	AMT	9/7/2011	53.75	77.05	43.35%	0.00%	Up to 68
PowerShares Water Resources	PHO	9/7/2011	16.42	21.22	29.23%	0.64%	Up to 22
Cisco Systems, Inc.	CSCO	9/7/2011	15.42	20.48	32.81%	1.20%	Up to 21
Deere & Company	DE	9/7/2011	78.97	88.67	12.28%	1.90%	Up to 92
Chesapeak Granite Walsh Trust	CHKR	2/3/2011	25.19	17.80	-29.34%	9.30%	Up to 26

Taxing Dividends

As I had written about previously, I did not believe the Federal government would allow tax rates on dividends to revert back to the pre-2003 tax levels. I felt this would occur because of the increasing amounts of retirees/seniors dependent upon dividend distributions to cover their living expenses. Such a move would not have been the wisest of political decisions for anyone seeking to be re-elected.

In the case that there had been an increase across the board on the amount of taxes taken per dividend distribution, it would have led to a sizable sell off on high yielding equities. Yet, I would have contended that the selling action was a an opportunity to buy.

Why? We're in a low yield environment, which has cornered many investors into unorthodox investments to achieve a regular income stream. Normally, very low risk investments such as money market accounts, savings, certificates of deposit and investment grade bonds could be employed to build a certain income stream. Under current conditions this task is much more difficult because interest rates are extremely low. Much more money is needed to generate an appropriate dollar amount in returns for the investor.

Investors have sought and found higher yielding investments via certain classes of stocks. These investments have more risk than a standard savings account, but bring the yield needed to secure a regular stream of income. The fear that a higher tax rate would drive investors away from such investments is short sighted. In the current environment, investors are stuck with these investments because they are the best alternative for a not so great situation. As long as the increase in tax wasn't egregious, investors would most likely be driven to buy more of such investments to compensate for marginal change in the tax rate.

More retirees means more investors that need investments that provide a stable source of income. Growth stocks cannot be depended on for such matters. High-yielding stocks that are stable and have a track record of paying and/or increasing dividend payments are a good fit for retirees in need of an income stream.

Personal Finance: Initial Costs and Maintenance & Operations

When making a large purchase with a shelf life that is expected to be several years (house, car, boat, RV…), it's wise not to limit your focus to only the initial costs. While it's important that you can financially afford whatever the upfront costs are, it is important that you understand and budget for the associated costs that will likely be incurred during the life of the purchase.

The problem that most people have is that the upfront cost is very apparent, while costs associated with maintenance and operations are not so apparent. Extra work must be done to identify these more 'hidden' costs. Consequently, many gloss over such analysis. Just because you don't see something coming does not mean it doesn't exist and it will not hit you in the face.

The reason identifying these not so apparent costs is so critical is because such costs are often not so small. Small costs that are not foreseen can typically be mitigated through minor adjustments in monthly spending habits. Larger expenses are much more burdensome.

For example, if you have your run of the mill sedan, you probably can buy a new set of tires at around $100 per tire. Between the cost of the tire, installation, and taxes, you probably can get out the door for around $450. Yet, change the vehicle to a luxury car, sports car or truck and your estimate will at least double, if not triple in price. What was a $450 maintenance cost to a $900-$1,350 expense.

If you do not or cannot account for the costs to maintain and operate whatever the item is you are considering purchasing, how do you know whether or not you can actually afford the good? The extra time it takes to do some research and a few simple calculations is well worth the effort. No one wants to find that the item they thought would bring so much joy is actually a curse.