

BIANCO RESEARCH, L.L.C.

AN ARBOR RESEARCH & TRADING, INC. AFFILIATE
1000 HART ROAD • SUITE 250 • BARRINGTON, ILLINOIS 60010
E-MAIL: jbianco@biancoresearch.com • WEB SITE: www.BiancoResearch.com
TOLL FREE 800-876-1825 • PHONE 847-304-1511 • FAX 847-304-1749

James A. Bianco, CMT

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MARKET FACTS

A Historical Look At The Markets
September 1, 1998

How Much Wealth Has The Stock Market Destroyed?

For the month of August, the S&P 500 declined by 14.43% on a total return basis (this is a preliminary number, the actual number may vary slightly). This is the market's worst month since the 21.52% loss in October 1987.

From a market wealth standpoint, August's decline has wiped out \$2.320 trillion of wealth (using the Wilshire 5000 index). The total capitalization of the market as of August 31st is down over 20% from its July 17th high and at its lowest level since mid-November 1997.

But, how have mutual fund investors fared? The attached chart suggests they have done **far worse** than the averages. Since the current bull market began in October 1990, investors have plowed \$1.06 **trillion** into domestic equity mutual funds – nearly 90% of all funds placed into equity mutual funds since their creation in 1924! At the highs of May 1998, these investors had unrealized profits of \$647 billion or 61%.

Using the DJIA closing level of 7,539, this wealth has taken a 43% hit all the way back to \$366 billion – or levels last seen in April 1997! How could wealth take a 43% hit when the averages are down 18% to 20%? Because the decline of 20% is calculated from the highs, whereas the wealth decline is calculated from investor's average DJIA price of all purchases since October 1990. (Note: we use the DJIA as a proxy for the returns of all domestic mutual funds because most people are familiar with this index. Had we used the S&P 500 or the Wilshire 5000 as our proxy, it would not have materially changed this analysis. We do not include dividends in our analysis and feel this should more than account for the underperformance that most funds experience.)

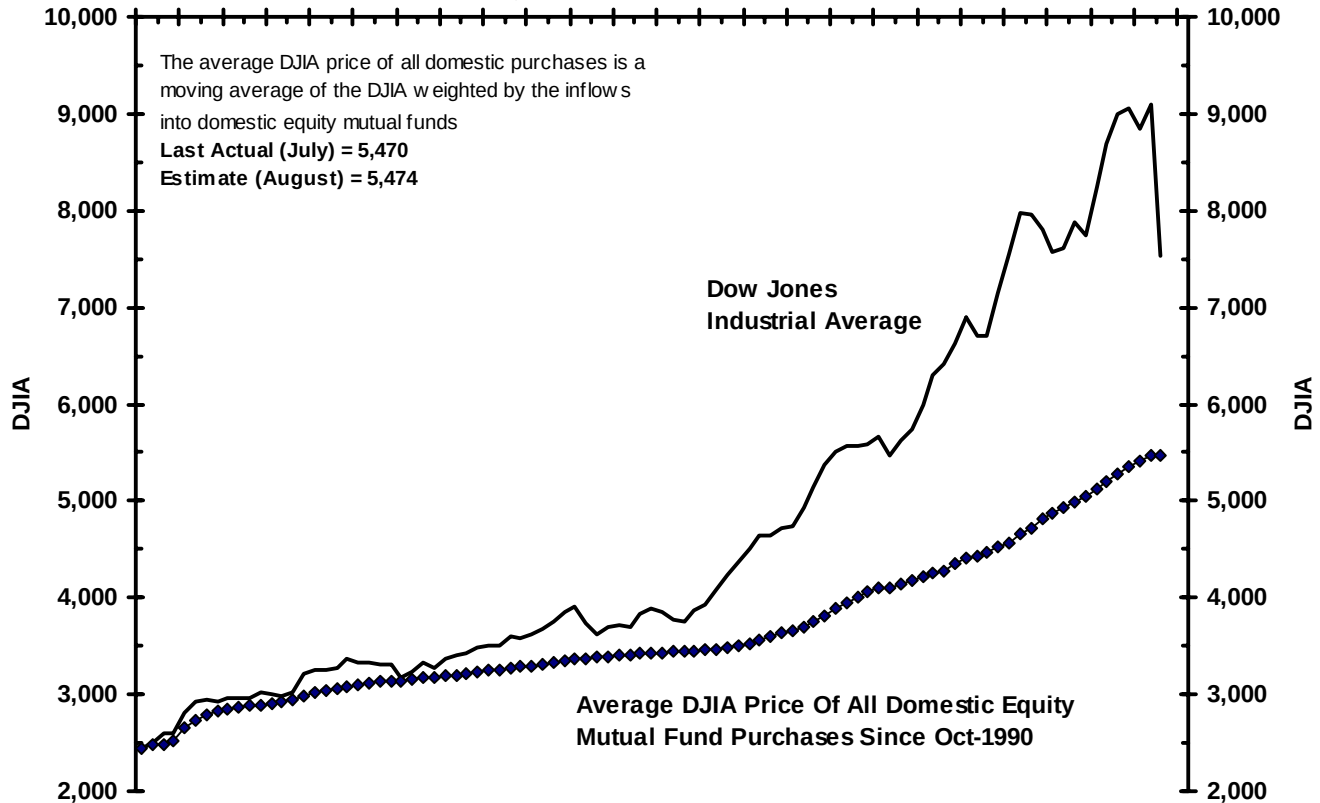
From a breakeven standpoint, the average price of all domestic equity purchases since October 1990 is approximately DJIA 5,474. (The S&P 500 equivalent is 635). This is only 18% below the current market levels – the narrowest profit margin since September 1996.

This level is important because we feel mutual fund investors will not aggressively sell until the market trades below their breakeven or average cost level. Historical testing of previous market declines (including equities in 1987, bonds in 1994 and emerging markets in 1995) show this time and again. Therefore, we find the estimate of August inflows of \$1.8 billion for all domestic equity mutual funds from *Liquidity Trim Tabs* (www.trimtabs.com) to be reasonable (this is the assumption we used in calculating August's losses). Mutual fund investors are not selling – they have stopped buying. The losses will have to get much worse before real selling starts.

Conclusion

From the high point of wealth creation in May of 1998, domestic equity mutual fund holders have seen 43% of their wealth disappear in the last few weeks. Economically speaking, if the stock market does not rebound significantly soon, this wealth destruction looks to be enough to impact economic performance. Bonds are correct to rally on the back of lower stock prices, since these lower stock prices will hurt the economy more than most other "conventional" economic events.

Measuring The Public's Breakeven Point



Measuring The Wealth Effect

Unrealized Profit Held In Domestic Equity Mutual Funds

