Despite Gains, Many Flee Stock Market

By E.S. BROWNING

The stock market is reaching toward new highs on the fourth anniversary of the financial crisis, but many people refuse to be lured back.

'I do not trust the stock market to put in lasting gains,' said Franklin Riesenburger, a lawyer and former buy-and-hold stock investor.

Even as stock indexes have doubled in value since the market low in March 2009, investors have yanked a net $138 billion from mutual funds and exchange-traded funds that invest in U.S. stocks, according to the Investment Company Institute, a mutual-fund trade group. Investors over the same period put $1 trillion into bond funds, a traditionally lower yielding but safer investment.

It marks the first time since 1981 that investors have pulled money from U.S.-stock funds for more than a year at a time.

Crumbling confidence in stocks reflects a broader loss of trust in the stock market and in the idea that the prudent investor could expect a comfortable retirement and even a measure of wealth.

The stock market has become the foundation of U.S. retirement savings, with nearly half of American families owning stocks. But wounded investors, worried about another big loss, are triggering a decline in stock ownership.

Market busts in the 1930s and 1970s soured previous generations of investors. Now, said money manager Steven Leuthold, of the Leuthold Group in Minneapolis, "I think we've lost another generation."
The signs of disaffection are widespread. The percentage of American families who say they own stocks or stock funds slumped to 46% in 2011 from 53% in 2001, according to the Investment Company Institute. Only a quarter of households with retirement plans were willing to take above-average investment risk in 2011, down from 33% in 1998, an ICI survey found.

Mutual funds, predominantly owned by individuals, widely reflect the investment patterns of ordinary people. Whether they made profits or losses after exiting the funds depends on when they bought. Regardless, it is now a cliché that small investors are less interested in the return on their money than in the return of their money.

Rosa White, a 27-year-old TV-commercial producer in Brooklyn, sold about half of her stock portfolio this spring and moved the cash to a money-market account. She is still buying stock funds through her 401(k) retirement account, she said, but plans to reduce those contributions. She would like to invest more aggressively but said she was afraid.

"Every other day on the news there's some crisis," she said. "The whole euro-zone collapse talk keeps going and going. If it's not Greece, it's Spain. Then there's the whole Facebook blowup."

Although most people don't like to tinker with their retirement accounts, the portion allocated to stocks in 401(k)-type accounts overall fell to 61% in July from 70% in early 2007, based on data from Hewitt, a firm that manages corporate benefit plans.

The stock allocation would be even lower except that many companies are automatically putting new employees in so-called target date plans, which direct most of their contributions to stock.
funds, said Patti Bjork, Hewitt’s retirement research director.

“The fear in the mind and heart of the investor is more acute now than it was in the ’70s, because the investor class today doesn’t know what to do, doesn’t see an option,” said David Kotok, president of Cumberland Advisors, which manages about $2 billion in Sarasota, Fla.

Many investors are afraid of the real-estate market and are unhappy with bonds. "People don't want to be in cash at a zero interest rate and have a growing fear of longer-term bonds because the yield is so low and the price risk is now high," Mr. Kotok said.

Demand for bonds, together with central bank policies aimed at stimulating the economy, has pushed interest rates and bond prices to extremes. Prices and yields will eventually return to more normal territory, and people invested in bond funds could see future declines.

Still, Mr. Kotok said, clients call him asking to get out of stocks. "The conversation will go something like this: 'The market is up enough, I don't like the way things are, take me out and put me in bonds.' I get that every few months. I rarely get a call telling me to go the other way," Mr. Kotok said.

Some clients say they no longer trust Wall Street. "I get the reaction, they are a pack of thieves and liars and you can't trust them," he said. "The news flow continues to reinforce it."

A parade of Wall Street scandals has given small investors the impression they are at a disadvantage, beginning a decade ago with criminal behavior at Enron and WorldCom. More recently, bankers at Barclays PLC admitted to trying to manipulate for years an interest rate widely used as the basis for U.S. mortgage rates; J.P. Morgan Chase & Co. disclosed a trading goof that has cost the bank at least $5.8 billion; and Morgan Stanley and the Nasdaq Stock Market have been criticized for their handling of Facebook’s stock offering, which cost investors billions.

"I’ve changed my views remarkably on how to invest in the market," said Franklin Riesenburger, 66-year-old lawyer in Cherry Hill, N.J.

Through the 1990s, Mr. Riesenburger was a dedicated buy-and-hold stock investor, owning no bonds and delighting at the risks of the stock market. He made good profits in small technology and biotech stocks. But after technology stocks collapsed in 2000, he decided the world had changed.

"On July 18 of that year I started my new wave of investing," he said. "I sold everything."

Today, Mr. Riesenburger considers the stock market a scary place. Over the past year, he gingerly put money back into such blue-chip stocks as AT&T, Coca-Cola and Exxon Mobil. He sold those stocks as global economic growth slowed this summer.

In late September, he returned about a third of the money to blue-chip stocks and a gold fund, betting that Federal Reserve stimulus would push those investments higher. Depending on events, he said, he will either increase that bet or pull out his money.
Most of his savings remains in bonds, real estate and money-market funds. "I do not trust the stock market to put in lasting gains," said Mr. Riesenburger. His main concern now, he said, is avoiding a loss.

As in the 1930s and 1970s, when stock price collapses and financial scandal mangled savings, it could take years to rebuild confidence, Mr. Leuthold and other money managers said.

After the 1929 crash, the Dow Jones Industrial Average didn't return to its previous high until the 1950s. After the stock market turmoil that began in 1966, the Dow didn't start recording sustained gains until the 1980s.

Beginning in 1971, investors withdrew money from stock funds for 11 consecutive years as the U.S. struggled with oil crises and stagflation, the pernicious combination of inflation, high unemployment and little growth.

Mutual-fund firms are seeing another exit today. Demand for U.S.-stock funds peaked in 2000, after technology stocks collapsed and the market began a 2½ year decline.

Some optimism returned in 2003, but flows into U.S. stock funds never reached 2000 levels.

People began taking substantial money out of U.S.-stock funds in 2008, the year Lehman Brothers Holdings declared bankruptcy, big banks sought a government rescue and the global economy teetered on a precipice.

The decade’s two financial calamities cost the stock market many long-term, stable investors who helped support the double-digit annual stock gains that created vast wealth in the 1990s.

Jay Greenblatt, a 75-year-old lawyer, said for years he had no stocks and held most of his money in tax-free municipal bonds. About 20 years ago, he said, he hired an investment adviser, who persuaded him to diversify into stocks.

Mr. Greenblatt did well, and he kept as much as a quarter of his money there until 2007, when he decided to exit. His investment adviser persuaded him to keep about 10% in stocks.

"I ski the biggest mountains all over the world. I have ridden my motorcycle all over the country. I love risk, but I still fear the market," Mr. Greenblatt said.

"There is just no stability in the world on anything," he said. "It is the fact that the entire nation, if not the world, is living on credit. It is the fact that the values of stocks have no real relation in my book to the earnings of corporations but rather in a popular sense are speculative and based upon puffing, PR, a presumed future growth."

Two weeks ago, worried about the U.S. election's impact on the stock market, Mr. Greenblatt sold his remaining stocks and put the money in bonds.

The flight from stocks could be worse. Retirement accounts still funnel billions of dollars into U.S.-stock mutual funds each year. In the 1970s and 1930s, 401(k) plans didn't exist, so the stock exit was more stark.

In addition, figures on exchange-traded funds probably overstate demand for stock funds among rank-and-file investors because they also are used by professional traders for hedging.

A pullback from stocks leaves trading increasingly in the hands of professionals—hedge funds and high-frequency traders that use hard-to-regulate computerized methods. That makes the market
more volatile, helping fuel such events as the "flash crash" on May 6, 2010, when the Dow Jones Industrial Average fell 700 points in eight minutes.

A decade ago, high-speed trading made up a small share of stock trading. Today, many large companies do little else, holding shares for as little as a second. They now represent more than half of all stock trades, according to Tabb Group, which tracks such transactions.

The trend away from the stock market has been reinforced by aging baby boomers, the oldest now well into their 60s. People nearing retirement often pull back from stocks to preserve their gains. Others who lost jobs in the downturn sold stocks to pay bills.

Some people shifted money into international-stock funds, banking on China and other fast-growing economies. But many have sold those mutual funds in recent weeks.

Mr. Leuthold said he saw the Great Depression's stock market hangover extend into the 1960s. "When I started as a broker in '61, we had a couple old guys in the office who had suffered through the Depression, and two of them, personally, would not own a share of stock," he recalled. "One said, 'I would only invest in real estate.'"

William Hackney, a partner at Atlanta Capital Management in Atlanta, Ga., recalled when investors abandoned stocks in the 1970s. Eventually, the U.S. economy and the stock market recovered, he said: "My point is, this, too, will pass."

But first, painful memories will have to fade.

"People are scared stiff to go through an '08 again," said Mark Pollard, a financial adviser in Princeton, N.J., with Merrill Lynch Wealth Management. "People do talk about that: 'Whatever you do, I don't want to go through an '08 again.'"