ON THE MONEY

The trend is your friend — until that nasty bend at the end

BARRY RITHOLTZ

On Investing

With these whopping 4 percent swings — up 500 points, down 500 points, up another 500 points, down another 500 points — traders have whiplash. We saw another huge move down Thursday, when the Dow, Nasdaq and S&P all lost big, plummeting 3.68 percent, 5.22 percent and 4.46 percent, respectively.

What is going on? It seems that 4 percent — plus or minus — is the new black.

According to Justin Walters of the research firm Bespoke Investment Group, there have been 283 swings in the Dow of at least 4 percent since 1900. That's less than 1 percent of the 30,414 trading days. More than a tenth — 10.95 percent — of those have come since October 2007. It's the same for the 622 days plus or minus 3 percent and 1,735 plus or minus 2 percent days since 1900.

The data confirm what you're probably feeling: This is nuts. It used to be that swings of 1 percent in equity markets were considered normal levels of volatility. And 2 percent moves were even less common. So if it seems like wild swings in the market are more frequent than ever, that is because they are.

But why all the Sturm und Drang?

A few weeks back, we discussed the reasons traders were rethinking risk. A combination of the slowing economy, a potentially weakening profit picture and European bank problems had finally convinced them that stock prices were too high.

But what investors really need to understand comes down to one word: Trend.

Markets tend to move in long-term cycles. The overall economy oscillates through periods of greater and weaker growth. These are driven by big macro factors that last not for quarters or even years, but decades. These changes lead to significant economic changes and are often the impetus of major expansions. Then, after a decade or two, they fade and are replaced by periods of softer growth, or worse.

Over the past century, numerous "secular" long-term trends have played out. The results have been surprisingly predictable. After the 1929 crash and Great Depression, markets floundered. It took until 1954 — 25 years! — to return to the nominal market highs.

The long economic trend after World War II was very supportive of markets. Millions of servicemen returned home, married, had kids, created the baby boom. We created suburbia, built out the interstate highway system. And after years of footing the wartime effort, the private sector could once again refocus on peacetime production of goods and services. All of this begat a huge expansion, and from 1946-66 we had a 20-year secular run in stock markets with 500 percent in gains.

But all good things must come to an end, and the market topped out in 1966. The Dow hit 1,000 that year, and it would not get above 1,000 on a permanent basis for 16 years — until 1982.

Markets may have been flat over this period, but they lost ground to inflation. In that long flat era, there were shorter term cyclical trends. Over that 16-year secular bear period, we had five major rallies that picked up between 25 to 75 percent, and five major sell-offs, including a 56 percent drop in 1973-74.

These secular cycles continue to play out even today. The beginning of the next major secular bull market was 1982. Driven by technology and finance, 18 years later, the broad indices had gained more than 1,000 percent.

These things always end with the markets getting way ahead of themselves. By 2000, the Nasdaq was over 5,000, the S&P 500 over 1,500, the Dow just under 12,000. Here we are more than a decade later, and all three major indices are below those peaks. And if history holds true, the current secular bear market probably has a few more years to run. It's a fair guess to say we are in the seventh inning or so.

Where does that leave us? Since the post-crash lows of March 2009, markets have enjoyed a nearly uninterrupted cyclical uptrend. (We did have that little bother with the flash crash in May 2010, but what's a structural hollowing-out of capital markets among friends?)

These trends are why savvy traders tend to give markets the benefit of the doubt. Experience teaches us that they can run longer and further than we should reasonably expect. That is why the end of any intermediate-term trend can take some time.

The rally that began in March 2009 looks to be running out of steam. Indeed, those gains have been among the best post-crash rallies of the past century. Only the 1932-33 and 1935-37 runs saw stronger rallies over a two-year period. The first saw the Dow Industrials double in two months. It gave back nearly all those gains by March 1933. From that low, the Dow once again doubled by July, only to give back about 26 percent by October 1933. And the next bear market rally — a two-year screamer from March 1935 to March 1937 — saw an astounding 135 percent in gains. That ended in yet another collapse, this time of 56 percent.

Compare that with the current run — the S&P 500 gained 105 percent from March 6, 2009, to May 6 of this year. It is getting harder to believe this run is still intact.

Life — and investing — is all about probabilities. We don't know what is going to happen in the future — certainly not with any degree of confidence.

What we can surely assess is a range of possibilities as to what might happen. To my eyes, it appears that the cyclical bull run within that broader secular bear has run its course. We are now in the midst of pricing in a slower economy, weaker profits — and lower stock prices.

I'll say it again: Investors should adjust expectations — and their portfolios — accordingly.

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A New York Stock Exchange trader on Thursday watches the market slip. Does it seem like wild swings are more frequent than ever? They are.

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STEVEN PEARLSTEIN

Costly patent arms race likely to escalate unless courts step in

PEARLSTEIN FROM G1

companies, venture capitalists and their cynical lawyers to stifle and discourage them.

The latest escalation in this arms race came last week when Google announced it would pay $12.5 billion to acquire Motorola's division that produces wireless telephones and smartphones. Analysts figure that less than half the purchase price is for the struggling handset operation. The rest is for Motorola's 17,000 software and telecom patents so it can defend its Android operating system — along with all the other companies that are using it or writing applications for it — all of whom are under legal attack from the likes of Microsoft, Apple and Oracle.

For years, these companies have complained bitterly about the economic damage caused by patent "trolls" — companies that exist solely for the purpose of buying up patents and using them to sue companies that might or might not be violating them. But having failed to reform the patent system, those same companies say they have no choice but to adopt their methods and tactics.

Google moved quickly on Motorola after it was outbid by the same Android rivals for a package of 6,000 patents put up for sale by what is left of Nortel Networks. The original asking price was $1 billion. It went for $4.5 billion.

As with all arms races, everyone admits this is crazy but nobody has the means to stop it short of mutually agreed-upon disarmament.

The best reporting I have found on the subject was by National Public Radio, which ran the results of an investigation last month as part of its "This American Life" series, in cooperation with its Planet Money staff.

The segment focused on a company called Intellectual Ventures, which was started by Nathan Myhrvold, the former chief technology officer of Microsoft. Myhrvold began collecting a war chest of patents while at Microsoft, at the suggestion of Bill Gates, as a defensive maneuver. But when he left, he took the patents with him and began buying more, using $5 billion from the likes of Stanford, Brown, the University of Texas and the Rockefeller Foundation and leading venture capitalists.

The original idea was not a bad one: to build a pool of patents large and broad enough that it could serve as a legal deterrent against unfair patent suits, not just for Microsoft but also for any company willing to rent it out, in essence, through payment of an annual licensing fee. A number of Silicon Valley companies that originally signed on as investors also signed on as customers.

To put a patina of innovation on the project, Myhrvold also invested some serious money to build a cool new laboratory in Washington state and hire scientists and engineers to come up with breakthrough ideas. And Myhrvold penned an article for the Harvard Business Review claiming Intellectual Ventures would be a "disruptive" force that creates an efficient market to allow innovators everywhere to capture the full value of their creativity.

What may have started out as a clever way to "turbocharge technological progress," however, seems to have morphed into something closer to a Jersey City protection racket. When Intellectual Ventures came knocking on the door of tech companies offering to license its patents, companies began to get the sense that it was an offer they couldn't refuse — and if they did, they might find themselves at the receiving end of a patent suit filed by Intellectual Ventures itself.

Indeed, by the end of 2009, Intellectual Ventures began suing companies for violating its patents. The first targets included Symantic, Dell, Hewlett Packard, Kodak and even Intel, reportedly one of its original investors. Also included were a number of those small entrepreneurial start-ups. And, as NPR discovered, Intellectual Ventures was sometimes doing it in a sneaky, underhanded way, acting through straw companies with no employees domiciled in empty offices in East Texas, where the federal court docket and juries have proved most receptive to patent suits.

Nathan Myhrvold started Intellectual Ventures to build a pool of patents.

None of this would be possible, of course, if all patents were as straightforward as those for a corkscrew or car battery. But products such as smartphones are a collection of thousands of little ideas and inventions, many that probably should never have received patents in the first place because they weren't particularly new or original, or could have been "invented easily by anyone trained in that particular art." Given the broad manner in which many of these patents were drawn, there are often several patent holders who could claim the same innovation.

To some degree, this has always been a challenge for the patent system, particularly with new technologies. Henry Ford and the Wright Brothers were involved in prolonged patent disputes. But it has been a particular problem with software or patents covering "business methods," or the look and feel of a product or how it can be used.

Next month, after six years of hand-to-hand combat between various industries and industry sectors, Congress is expected to complete work on a patent reform bill that should help by making it easier to challenge a patent before it is issued, or immediately thereafter. And the courts have recently tightened up the criteria for the damages that can be awarded when patents are violated.

What is missing from the bill, however, is any attempt to narrow the range of what can be patented in the areas of software and business methods to reflect the changing nature of technology and innovation. That's hardly surprising. The big companies that complain about abuse of the patent system are big patent holders themselves, with as much to gain as to lose from a restriction on what can be patented. The final bill is as much of a disarmament treaty as the business community would accept.

All of which means that the costly patent arms race is likely to continue until federal judges step in to stop it. It's more than a bit ironic that a conservative Supreme Court majority that has done so much to slam the courtroom door on consumers and workers has left it wide open for corporate interests running a legal protection racket. If there ever was an abuse of the judicial process, this is surely it.

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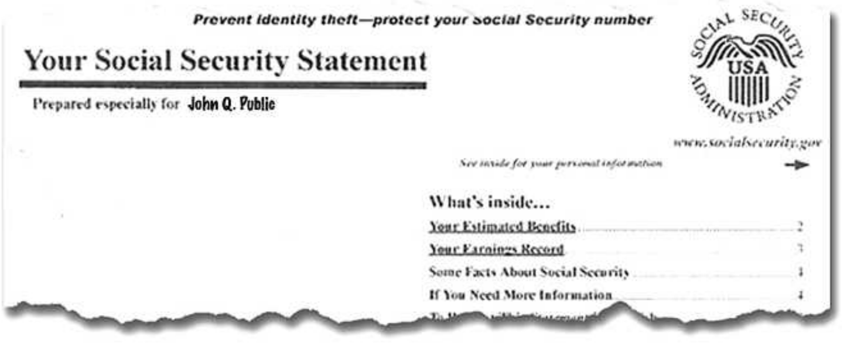
THE COLOR OF MONEY

The numbers don't add up? How to fix errors in your Social Security benefits.

COLOR FROM G1

Social Security listing my years of employment, how many quarters I had contributed, and an estimated amount I'd be eligible for if I take my benefits at 62, my full retirement age, and at 70. I never thought about retirement until recently. I never really paid attention to the statement. But upon examination, I notice that I'm only being credited with about a third of the years I actually worked. Is it possible to get this corrected with Social Security?"

People have been getting a statement from Social Security and many, like this person, probably have ignored them. The statements were sent to non-beneficiaries 25 and older each year about three months before their birthday. Those statements contained vital information, including a record of your earnings history, an estimate of how much you have paid in Social Security taxes, and estimates of benefits you and your family were eligible to receive.



Prevent identity theft—protect your Social Security number

Your Social Security Statement

Prepared especially for John Q. Public

SOCIAL SECURITY ADMINISTRATION USA

www.socialsecurity.gov

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But in April, the Social Security Administration stopped mailing out the annual statements. In testimony to Congress, Social Security Commissioner Michael J. Astrue said his agency was mailing 150 million Social Security statements a year. Social Security says it could save as much as $30 million a year by suspending the mailings.

For fiscal 2012, which begins in October, Social Security will resume mailing the annual statements to people 60 and older, a spokeswoman said. For all other workers, the agency is looking into providing the statements online sometime next year. You may be able to an estimate of your retirement benefit by going to *www.ssa.gov* and searching for "Retirement Estimator."

Okay, so what if you find that the information on the statement you did get this year is incorrect? (By the way, hopefully you kept last year's statement, so even if you don't receive one this year you can double-check the information.) You should be checking. This information is vital to your retirement planning. The amount of the Social Security benefit you can get depends on the amount of earnings reported to the agency. If your earnings record is inaccurate, that could mean lower benefits.

One of the reasons your record could be incorrect is that you got married or divorced and changed your name but never reported the change to Social Security.

If you discover income information missing on your statement, you'll need to find some proof of what you earned. This could be a W-2 form, an old tax return or a pay stub. After you have gathered your proof, contact Social Security. If you can't find proof, you may still be able to get the record corrected by providing Social Security with the dates you worked and your employer's name.

Finally, a reader wanted to know about using retirement money to buy a car.

"I will soon need to buy another vehicle. I have a 1997 Toyota Camry. I am a retired federal employee. I don't want monthly payments forever and am thinking about getting funds from my 401(k) to pay for it. Is this a good idea?"

I'm right back where I started. Remember, the less debt you have in retirement the better. So I wouldn't borrow to buy a car. Depending on your tax situation, I would first use savings outside the 401(k). If the 401(k) money is your only savings, use some of that money and get the most affordable and reliable used car you can find.

Readers can write to Michelle Singletary c/o The Washington Post, 1150 15th St. NW, Washington, D.C. 20071. Or by e-mail: singletarym@washpost.com. Personal responses may not be possible. Please also note comments or questions may be used in a future column, with the writer's name, unless a specific request to do otherwise is indicated.