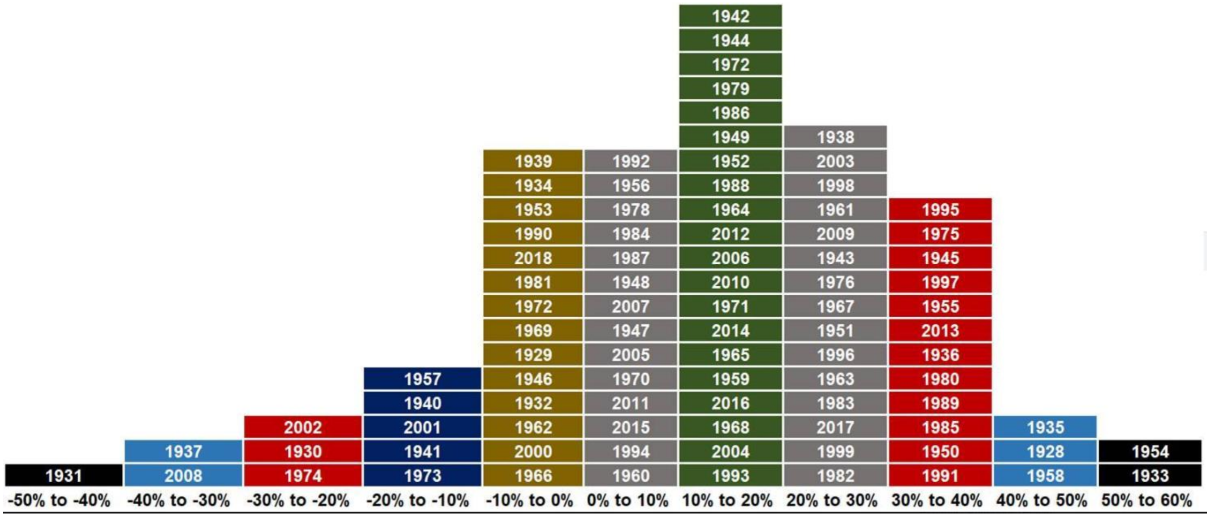
What to expect from investing in stocks? Two chart explanation! 90 years of stock market history

Dear fellow investor,

I recently came across the following chart that shows the yearly returns across 90 years for the S&P 500.



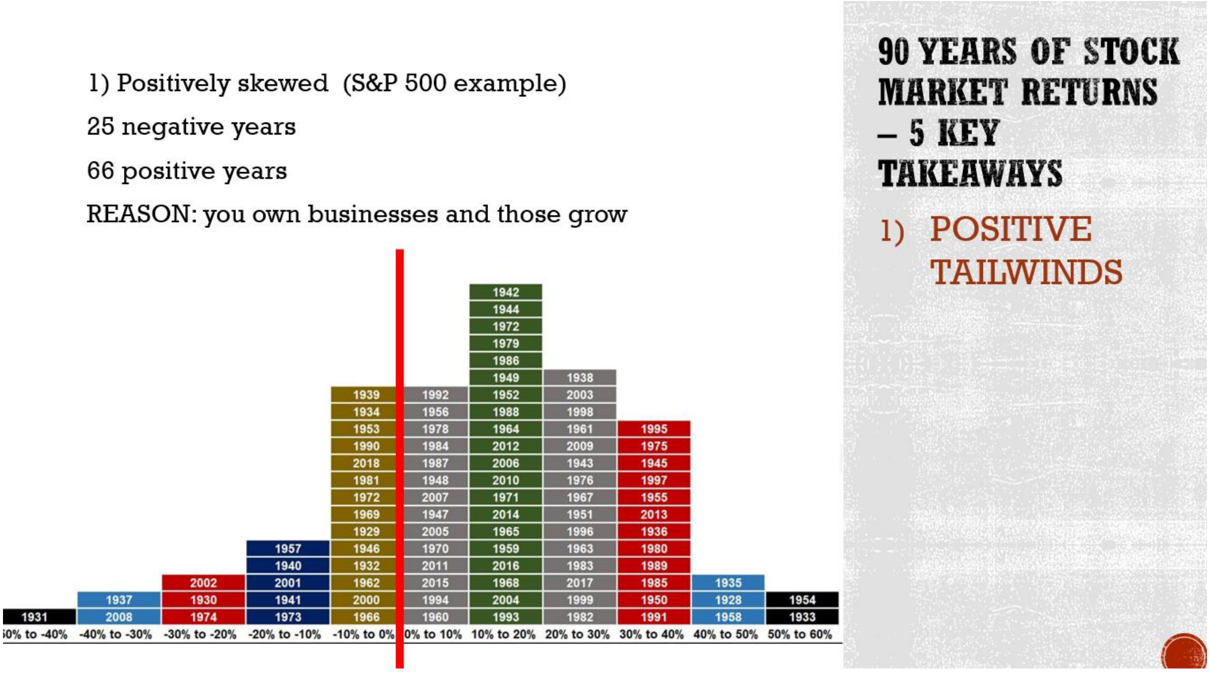
In combination with the following chart from a [Mohnish Pabrai YT lecture]() showing the long-term evolution of the above for the Dow Jones index, one can learn a lot about what to expect from investing in the stock market and especially when.

There are 5 things I wish to focus on:

1) Investing is all about POSITIVE TAILWINDS
2) But keep in mind the VOLATILITY
3) Years don’t mean much – TRENDS do
4) VALUATION matters
5) At the end, it is about YOU

1) Investing is all about positive tailwinds

Both charts tell the same story. Over 90 years, there have been 25 years with negative returns against 66 years with positive returns.

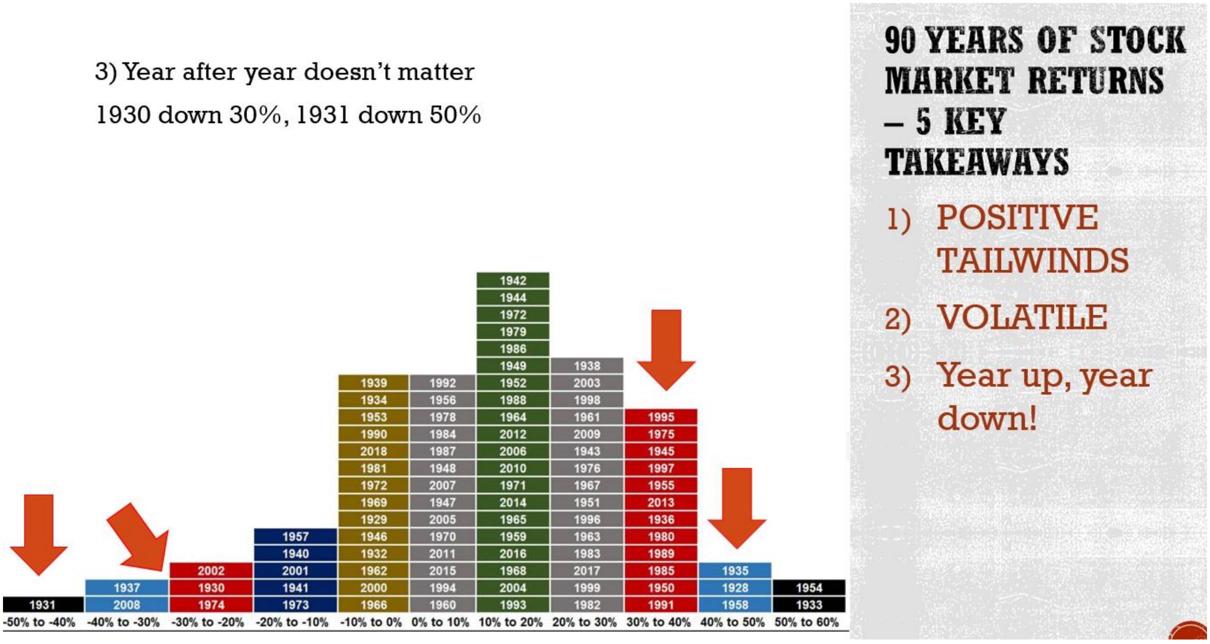


Or, the Dow Jones index went from 16.15 points in 1898 to the current level of 29,000.

Thus, investing in stocks/businesses is a positive sum game, one you can hardly lose if you play smartly.

2) & 3) However, expect volatility

It is not unusual for stocks to fall 50% in a year or to increase 50% or even more in a year. Keep in mind the positive tailwinds where what you can lose is just 100% what you invest but the upside is unlimited.



However, whenever investing in stocks, you must know that there is a 5% chance you will see your holdings drop more than 20% in the next year and a 10% chance those will drop more than 10%. That is a given and something to simply take as a risk. It is up to you to see how that fits your investment requirements and financial possibilities.

Further, the stock market works in trends – stocks are rarely flat, stocks go up or go down. However, stocks don't always go up and it could take a long-time for them to surpass their previous highest point, sometimes decades.

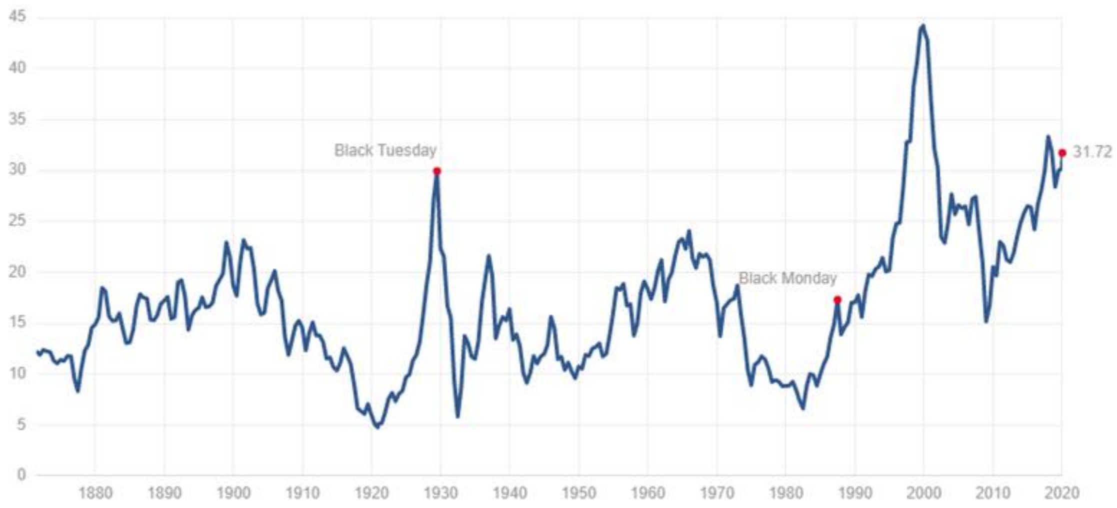
It took 12 years for the DOW to reach and surpass the 2000 dot-com bubble level, 17 years to go above the late 1960s stock market exuberance and a long 25 years to reach the same level as in 1929.

So, this is something that can happen anytime, especially if you look at real return (returns adjusted for inflation). However, when stocks don't go up most people forget the most important thing when it comes to stock market investing:

WE INVESTORS, WE BUY BUSINESSES AND ACCUMULATE WEALTH OVER USUALLY A LONG PERIOD OF TIME – THUS – WHEN STOCKS GO DOWN OR ARE DOWN – YOU BUY THINGS ON A DISCOUNT – LONG TERM, THIS AMPLIFIES YOUR WEALTH as you are able to accumulate more!

4) Valuations matter

Despite the fact that stocks usually go up over the long term – something that gives you a hint on what to do are valuations. Over the short historic time frame that we have data on, one factor shows some pattern characteristics – valuations and returns.



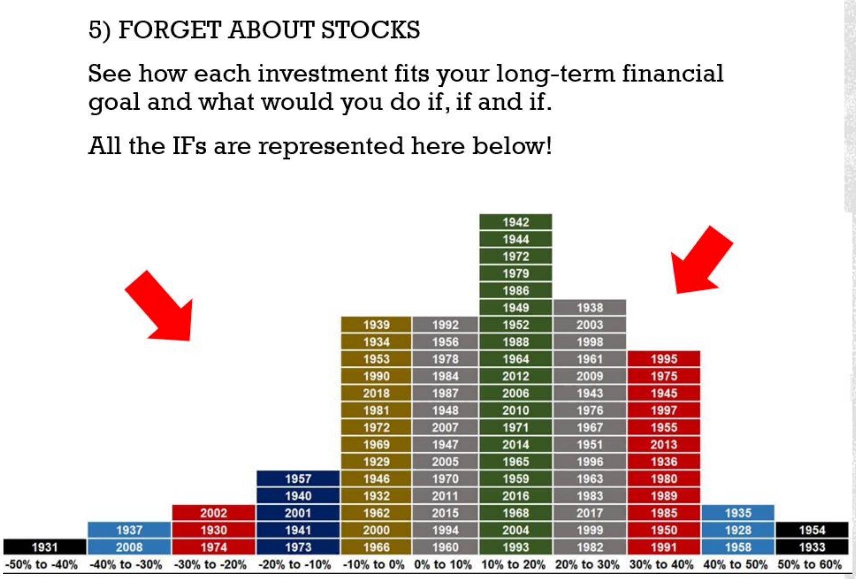
S&P 500 CAPE Ratio – Source: Multpl

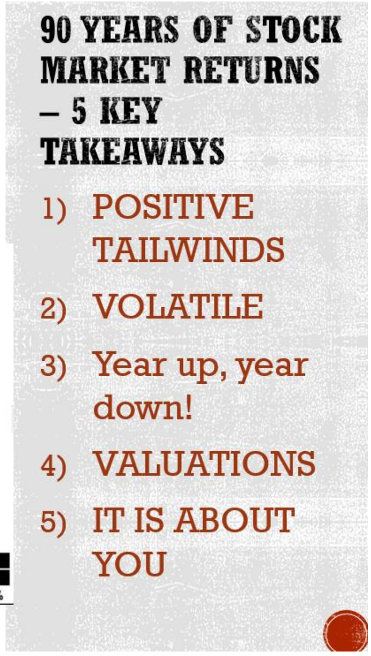
When valuations (the relation of the price you pay and the earnings the businesses make) were high, investment returns were low and it usually took a long time to make your money back.

However, when valuations were low, like it was the case in 1932, the 1950s, 1974, 1982, 2009, the subsequent stock market returns have been extremely satisfactory.

The key is to always check what is the business yield of whatever you buy. This makes investing much easier – you simply buy when you are happy owning the asset given the yield it offers – if the price of the asset goes down – you happily buy more or just reinvest the dividend – if the price of the asset goes up – you compare it to other options or simply sell everything and enjoy life😊. This leads to the final point of this lecture:

5) Investing is all about you





This short story shows what can happen in the stock market and that whatever happens, one can come out victorious. If stocks go down, you buy more, if stocks go up, great.

However, when investing, you have to have the right attitude to have such a flexible approach. If you can’t have such an approach, it is better not to invest in stocks. I see too many betting their retirement hoping the stock market will be skewed to the right side of the above chart. But then, what usually happens, is that the stock market crashes like it was the case in 2009, many sell in panic, because they were betting and the outcome isn’t favourable.

I will never forget that chat that I had with a former professor of finance when I was teaching at the Amsterdam Business School – he had a lot of money in stocks and sold everything in October 2008 because he couldn’t watch his money disappear day by day. We had our chat in 2015 and he was just starting to enter back into the market with what was left. The man lost more than a quarter of his long-term life cycle wealth just because he made the opposite of what had to be done. He practically lost what he made over 10 years of hard work – thus a quarter of his financial wellbeing – probably even more given the reaction stocks had since 2009. Instead of being a millionaire by now, he is behind from where he was in 2007.

5) FORGET ABOUT STOCKS

If stocks go down, buy more, if those go up, GREAT!

My former colleague's mistake – a trap many fall into!

90 YEARS OF STOCK MARKET RETURNS – 5 KEY TAKEAWAYS

1) POSITIVE TAILWINDS
2) VOLATILE
3) Year up, year down!
4) VALUATIONS
5) IT IS ABOUT YOU