50 Years of Bad News… and an Average Annual Compound Return of 10%!

It's often said that the stock market has to climb a "wall of worry", and the situation we are in today vividly illustrates this notion. U.S. debt has been downgraded, the whole of Europe appears to be gripped in an economic straightjacket, and the storm clouds of a dreaded double dip recession appear to be looming on the horizon. Definitely not a fun time to be looking at your portfolio and wondering what to do next!

So… what's new?

Sometimes a look at the past helps us put today into better perspective. Are the headlines we see these days really that unusual? The answer is no. Regardless of the past period examined, there always seems to have been a crisis of some sort gripping the world and threatening it with financial Armageddon. The table below covers half a century from the beginning of 1961 till the end of 2010, a period marked by a seemingly endless series of threatening events. And without minimizing our current problems, many of these past events appear to be far more serious than the ones we face today.

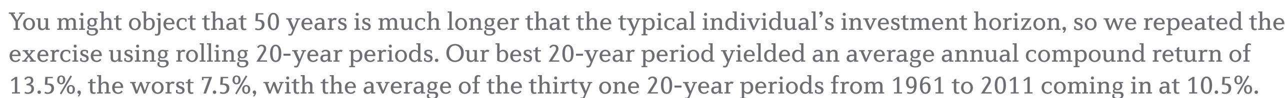
Bad News Fails to Derail a Long-Term Trend

Growth of $100 invested in the S&P/TSX Total Return Index

Year	Event	Year	Event
1961	Berlin wall erected	1987	Black Friday - Historical Market Crash
1962	Cuban missile crisis	1990	Persian Gulf crisis / Iraq invades Kuwait
1963	Kennedy assassinated	1991	Coup d'état in Russia
1964	Gulf of Tonkin	1993	Bombing of World Trade Center
1966	Vietnam War escalates	1995	Second Quebec referendum
1968	USSR invades Czechoslovakia	1997	"Asian Flu" financial crisis
1970	US invades Cambodia - new peak in Vietnam war	1999	Y2K paranoia
1971	Wage / price freezes	2000	Tech bubble bursts
1973	Energy crisis / Arab oil embargo	2001	9-11 terrorist attacks
1974	Nixon resigns to pre-empt impeachment	2002	Major accounting scandals sap confidence in financial system
1975	Clouded economic prospects	2003	War in Iraq
1977	Markets begins a major slump	2005	London metro and bus bombings
1978	Interest rates rise - Stagflation	2007	Subprime crisis
1979	USSR invades Afghanistan	2008	Global financial system near collapse
1980	Oil prices skyrocket, first Quebec referendum	2009	Major equity markets 50% below their peaks
1981	Short-term interest rates in Canada hit 21%	2011	US debt downgraded, threat of double dip recession

Common Stocks have stood the tests of time… and tribulation

Using the S&P/TSX Total Return Index as a proxy, over the past 5 decades of war, political upheaval and economic turmoil, Canadian common stocks have managed to deliver an average annual compound return of 10.05% - well in excess of what guaranteed investments would have produced over the same period. A $ 100 investment in the S&P/TSX total return index in 1961 would have grown to more than $12,000 over this period, despite a near constant stream of worrisome headlines.



You might object that 50 years is much longer that the typical individual's investment horizon, so we repeated the exercise using rolling 20-year periods. Our best 20-year period yielded an average annual compound return of 13.5%, the worst 7.5%, with the average of the thirty one 20-year periods from 1961 to 2011 coming in at 10.5%.

Today we think you should find comfort in the fact that the risk/reward principle has withstood the test of time, and common stocks have done a good job of providing a long-term growth component for portfolios, even over periods of near constant turmoil.

Common Stocks – Please use according to instructions

There have been a number of bull markets over these 5 decades – periods where stocks looked like a sure-fire way to make some quick money. But there have also been many, many instances like today where there seemed to be compelling reasons to dump stocks and seek refuge in the relative safety of bonds or GICs. This is what gives rise to an unfortunate cycle of "buying high and selling low"- the results that this behaviour produces are responsible for the widely held opinion that common stocks are a risky investment.

We think that like any powerful tool or medicine, stocks should come with an instruction booklet, because this asset class must be used properly to produce the desired results. Time has proven that stocks richly reward investors who are patient and disciplined. But time has also proven that investors who act and react impulsively will usually have quite a different experience.

The "Ten Commandments" of Investing

In the interests of brevity and simplicity, below we have tried to distill into ten simple points the advice we have for investors who feel they are caught in the eye of the storm and are looking for guidance. Call them the ten commandments of investing. They worked well in the past. And we are confident they will work well today… and tomorrow.

1. Volatility is a fact of life when it comes to financial markets;
2. Volatility creates opportunity;
3. If markets weren't volatile, stocks would deliver the same returns as guaranteed investments;
4. Market downturns generate paper losses – losses which are only realized if you sell;
5. Market downturns create buying opportunities for un-invested cash;
6. Long-term investment risk is managed with asset mix;
7. Your risk tolerance, objectives and time horizon should lead you to an investor profile that corresponds to a target asset mix;
8. If you have a long-term investment strategy, it shouldn't be abandoned because of short term considerations;
9. Measured periodic tactical shifts can be part of your strategy, but making whole-scale changes to your target asset mix in an attempt to try to "time" the market is generally a recipe for poor returns;
10. Given adequate diversification to reduce individual security risk to an acceptable level, the biggest single factor in producing good results when investing in stocks is having an appropriate time horizon, and patiently riding out periods of volatility!

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