

## Life Span Versus Attention Span Investing

As the year and century near a close, it is time to step back and review long run trends in the U.S. stock market, realizing that in this age of Internet IPO's, "long term" to many speculators means anything longer than eleven days. The worst mistake most investors make is to extrapolate the recent past forever into the future --e.g. since the market has appreciated 26 percent a year since 1994, plug 30 percent annual returns into your retirement calculations for the next 20 years.

***Unlike science, progress in finance tends to be circular -- avoiding our parent's mistakes only to repeat the mistakes of our grandparents.***

The enclosed chart shows the history of the U.S. stock market over the past century. While the chart does not trace a perfect sine wave, three super-bull markets have marked this century. Unfortunately, investors have also had to live through the periods in between the three super-bulls. With three super-bulls in 100 years, long-term investment cycles seem to average about 33 years. If the coming century is like the current century, anyone who might live another 33 years should plan on a super-bull market *and* one of the less gratifying periods.

At the tops of the super-bulls ending in the 1920's and the 1960's, investors were also probably extrapolating past returns into the distant future. Pundits were explaining why the business cycle was repealed because Congress or the Federal Reserve could "fine tune" the economy. Futurists were touting the "new era" brought on by the advent of new technologies that changed everything. Sound familiar? While we are great believers in the astounding potential of the Internet and the microprocessor, the new technologies of previous super-bulls (radio and autos in the 1920's, computers in the 1960's) were pretty important too.

The chart shows nominal returns, unadjusted for inflation. If we look at inflation-adjusted returns, an interesting pattern develops. The super-bull periods are of widely varying magnitude. In the bear markets (actually, we prefer the term "return-challenged") of 1916-22, 1929-32 and 1966-82, however, the inflation adjusted price declines were all around 75 percent. In the 1916-22 and 1966-82 bears, these horrendous returns were masked by rapid inflation. While it was awful to live through, the decline in the early 1930's tends to be overstated because deflation was cutting the cost of living. In the scientific world, progress tends to be cumulative. In the financial world, it tends to be circular, as people avoid the mistakes of their parents only to repeat the mistakes of their grandparents. The alternating inflation/deflation bear markets raise the question of whether we should stop patting ourselves on the back for beating inflation and worry a little more about the potential for deflation.

Much has been written recently about the superiority of stock market investing over the “long run.” While we believe this is true, it’s easy to convince investors of the superiority of stocks after the biggest bull market in U.S. history. If the pundits were surveying the investment scene in 1982, just as the great bull started snorting, they might have calculated that, in real terms, the price of the S&P 500 index was at about the same level as in 1906. That span of 76 years would be unlikely to strike anyone as the “short run.” Such calculations tend to be dramatically affected by end-period dominance – it matters a lot when you start and stop counting. While stocks *are* superior investments in the long run, it does not mean they automatically provide you with the returns you want (or need) at the time you want them. The “long run” may be longer than you think.

***One would not conclude on Labor Day that the recent good weather heralded a “new era” in which winter was banished due to fine-tuning by the weatherman.***

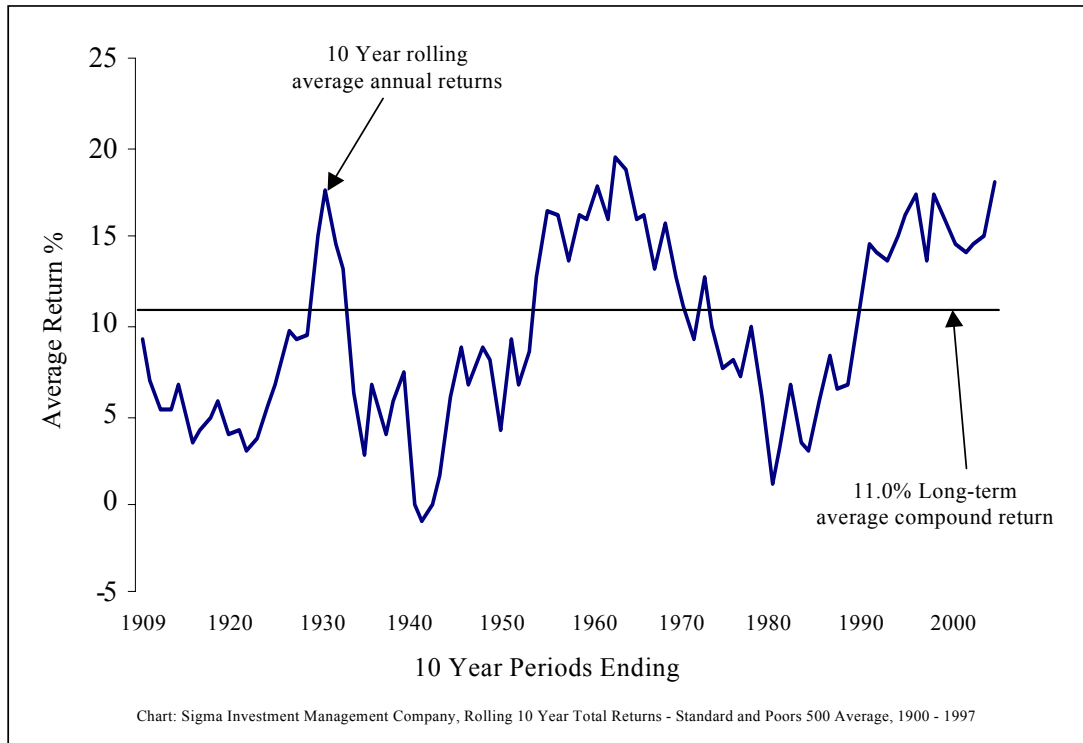
Many people have become significantly more aggressive in their investments in the past few years. For these people, our chart should provide some cautionary perspective – the times you want to be most aggressive are periods like 1922, 1932 and 1982, when everyone thinks the wheels are coming off the wagon. The periods when you wanted to be the most conservative were in 1912, 1929 and 1968, when everyone thinks the world had reached a state of perfection. While it’s true that today’s weather is probably a good predictor of tomorrow’s, it would be a mistake to conclude on Labor Day that winter is impossible because we have entered a “new era.”

A more positive conclusion, and perhaps one more in line with the holiday season, is that the U.S. stock market has been the best investment this century. Even though there have been three horrendous real declines, the market has eventually recovered. Just when people gave up hope, things got better. The market discounts the future, but selling everything because you are pondering the demise of the earth when the sun eventually burns out is just as wrong-headed as chasing Internet stocks that are discounting earnings into the hereafter. In the U.S., long-run pessimists have always been wrong.

If you would like an investment plan more oriented to your life span rather than your attention span, contact us.

*Data source on real returns: Global Financial Data. ([www.globalfindata.com](http://www.globalfindata.com), (818) 284-0341).*

# A Century of Stock Market History - What Makes an Average?



To eliminate the confusion over the changes in absolute market levels the chart shows 10 year rolling average annual returns. In other words, each month on the chart shows the average annual total return from the U.S. stock market over the preceding 10 years.

