View from the Thames:
This time is not different

Deon Gouws - CIO, Credo Wealth - 20 March 2020

When stock markets around the world go into freefall, it's normal to question the whole concept of equity investing. What's the point of having a large chunk of your life savings exposed to such a volatile asset class, after all?

First, some historical perspective. Only last month, the Credit Suisse Research Institute published the latest annual instalment of their Global Investment Returns Yearbook. The document consists of some 48 glossy pages of relatively small print, with a number of interesting conclusions about asset classes, themes, and factors, all divided into different regions of the world.

Arguably the most important statistic, however, is one that hardly changes over time: if you had invested one dollar in the US stock market in 1900 and kept on reinvesting dividends, you would have grown the purchasing power of your money by 1,937 times over the ensuing 120 years. This equates to a 6.5% annualized real return (yes, after taking account of inflation).

If one had decided to be a bit more diversified and bought a global equity index rather than committing all your eggs to purely an American basket, your real return would have compounded at a slightly more modest 5.2% over the full 120-year period.

Here's the nub: even after the turmoil of the past few weeks, with equities around the world entering bear market territory, these numbers hardly change: a 20% drawdown shaves less than 0.2% from the long-term returns quoted above. ⏩

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I understand that none of us can realistically afford to have an investment horizon of a century or more, but statistics such as these do serve to underscore the value of equity exposure in building long term wealth. It also illustrates the power of compounding – the most powerful force in the universe, as reportedly described by Albert Einstein.

It's useful to stand still at a time like this and reflect on what equity investing really means. Unless you're a day trader, buying shares on the stock market should never be seen as a "bet" on the likelihood that the price will go up over any short timeframe; as Warren Buffett famously teaches us, we should always think about investing in terms of acquiring a piece of a business for the longer term. And if you were happy to buy any business only a few weeks ago, at a price which presumably represented decent value at the time, why should you pay any attention to what a volatile "Mr Market" may be prepared to pay for your interest on a daily basis when he happens to wake up with a cough a short while later?

Think of it this way: stock markets enable you to invest alongside the founders of the greatest businesses in the world: if you buy into their companies, you effectively get the likes of Bill Gates and Steve Jobs and Elon Musk (as well as the teams reporting to them) to work for you on a 24/7 basis. You thus stand to benefit from all their creativity and foresight and hunger and drive and long hours and business acumen and management skills.

None of this changes when there's a global pandemic on the loose; on the contrary: entrepreneurs such as those mentioned are already thinking of prospective solutions and how they could benefit from it. Just imagine the riches that will accrue to those who manage to roll out the first coronavirus vaccine?

By investing in equities, you back the forces of human endeavour, animal spirits, free markets, and entrepreneurship. Over time, this powerful cocktail will always lead to economic growth and positive returns, even if some blips occur along the way.

The biggest danger to investors' wealth is never the next correction or bear market, but their own behaviour when one of these events inevitably happens: will they blink at the bottom, sell out at what proves to be exactly the wrong time, and end up suffering the inevitable opportunity cost as a consequence?

It is easy to say things like this when the mood is bullish and equities are trading at or near all-time highs. But every now and then, our resolve is tested and this point really comes into focus. The last few weeks have clearly been such a time.

In closing: the stellar 120-year returns quoted earlier have been achieved over a period which included two world wars, the great depression, the assassination of a US president, a major oil crisis, September 11, the global financial crisis, as well as the Spanish Flu and a number of other pandemics.

And of course there have been several booms and busts along the way… but longer term investors have always been rewarded for their patience. Why should it be any different this time?