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LORING WARD

Portfolio Perspectives

Monthly Insights for Investors

What if Rip Van Winkle Invested in The U.S. Stock Market?

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Nearly 200 years ago, the American short story “Rip Van Winkle” became an instant classic. The main character, Rip, is a simpleminded soul who lives in a village by the Catskill Mountains. He is an unambitious man who is very good at avoiding two things: work and his wife.

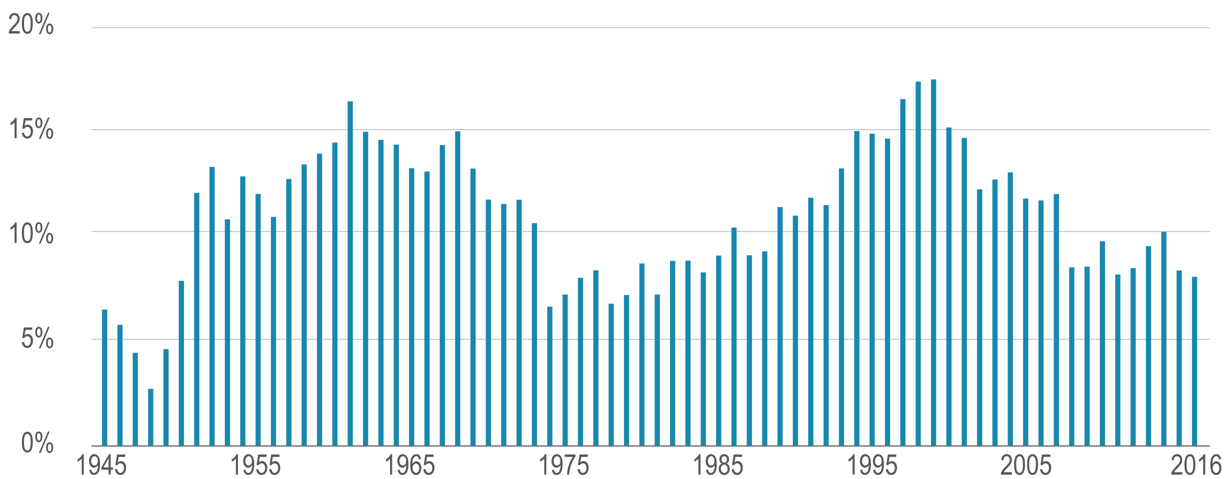
One day, while doing what he does best, he wanders into the mountains to go hunting, meets and drinks with a strangely dressed crew, and falls into a deep sleep after drinking their liquor. He awakens and is surprised to find that his dog is gone, his rifle has rusted, and he now has a long beard.

Rip makes his way back to his village only to discover that everything has changed. His wife has died, his friends are gone, and the portrait of King George III in the tavern has been replaced by a portrait of someone he does not recognize — General George Washington.

Rip Van Winkle had been sleeping for 20 years! And in the process, he missed one of the most exciting periods in the history of this country — he slept through the American Revolution.

Well, what if Rip slept through the worst 20-year period in stock market history?

U.S. Stock Market 20-Year Rolling Returns Ending 1945 – 2016



Source: U.S. Stock Market represented by the CRSP 1-10 Index. CRSP data provided by the Center for Research in Security Prices, University of Chicago. Past performance is not indicative of future results. All investments involve risk, including the loss of principal. Indexes are unmanaged baskets of securities in which investors cannot directly invest. Stock investing involves risks, including increased volatility (up and down movement in the value of your assets) and loss of principal.

If Rip had the opportunity to invest in the U.S. stock market before he slumbered, he may have woken up a wealthier man. The chart on the previous page shows the overlapping returns — often referred to as rolling returns — for all of the 20-year periods between 1926 and 2016.

If Rip had fallen asleep during the worst 20-year period for the U.S. stock market, the 20-year period from 1929 to 1948, he would have slept through the stock market crash of 1929, the Great Depression and all of World War II, which included the fall of France to the Nazis, Pearl Harbor and D-Day.

Looking back with hindsight, these events would likely scare even the most disciplined of investors out of the stock market. Did I mention that Rip also would have slept through the inauguration of the New Deal[1] — what some considered socialism — and an increase in top tax rates from 25% to 63% and eventually 91%[2]!

These are the events that kill capitalism and market growth, right? Yet, it is a 20-year period that rewarded investors in the U.S. stock market with a return of almost 3% per year. To put that into perspective, $100,000 compounded at 3% per year for 20 years is $180,611,[3] almost double the original investment. Not bad despite all that happened during that period.

What if I told you Rip fell asleep during a period that would experience the Cold War, Black Monday, savings and loan bailouts, the Persian Gulf War, the Mexican peso collapse, the Asian currency crisis, the Russian financial crisis, and the failure of Long-Term Capital Management — one of the largest hedge fund collapses in history?

What would you guess Rip earned investing in the U.S. stock market during that 20-year period? He must have lost money! How could he not?

Headlines can be deceiving. The market would have rewarded him with just over 17% per year for 20 years. To put that into perspective, $100,000 compounded at 17% per year for 20 years is $2,310,560.[3] This period — 1980 to 1999 — happens to be the best 20-year period since 1926 by the way. I bet you wouldn't have guessed that given the events mentioned.

If we look back at the headlines over the last 91 years between 1926 and 2016, it is hard to believe that every 20-year period earned a positive rate of return. In fact, the average of all 72 20-year rolling periods between 1926 and 2016 is 10.91% annualized. What does that mean in dollar terms? If we compound $100,000 by 10.91% per year for 20 years we get $793,227.[3]

What am I getting at with this analogy? We worry that many investors may view their stock market investments the wrong way. We believe you should view your investment portfolio the same way you view your house.

Think about the value of your house and its price fluctuation over time. The price is certainly volatile and it is worth more or less depending on the day, the season, the market and its condition. The same news and market conditions that affect stock market prices — unemployment, interest rates, political unrest, etc. — affect the price of

[1] *Thomas, Norman, "Is the New Deal Socialism?", Columbia Broadcasting System, 1936, http://www.chicagodsa.org/thomasnewdeal.html*

[2] *2014 Morningstar Index chart*

[3] *CRSP 1-10 Index*

your home. The difference between your house and your stock market portfolio is that you don't have up-to-the-minute price information for your house so you don't worry or react to its daily price fluctuation.

Now I'm not advocating you turn a blind eye to your investments and sleep for the next 20 years. What I am advocating is that you think differently about the stock market. Stop thinking about the stock market as a game you win or lose. And stop viewing daily price fluctuations as wins or losses.

The stock market is composed of thousands of individual companies run by millions of people incented to innovate, optimize and grow shareholder wealth. Companies that don't do these things go away and companies that do keep going. History has shown that the wealth created by the companies that do, more than offset the ones that don't, which is why the stock market has gone up over time.

Think of investing in the stock market as part of the process to reach your retirement goal. The value of the market will change every day over the next 20-30 years. Some days it will be higher and some days it will be lower but historically returns in the stock market over the long term have been positive. The stock market has been one of the greatest creators of wealth in human history and chances are you will need to capture some of its growth if you are to reach your long-term goals.