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Portfolio Perspectives

Monthly Insights for Investors

Markets Reward Long-Term Investors— Most Stocks Don't

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The fundamental value proposition of active management is that skilled managers can successfully pick winning stocks (and avoid poor performers). Of course, the results historically have been far from encouraging, with the majority of active managers failing to beat their benchmarks or sustain any period of outperformance they are able to eke out.

Surely it can't be so hard for experienced money managers with access to cutting edge research and technology to identify stocks that will do well (or poorly)?

But a new study, *Do Stocks Outperform Treasury Bills?*, from Hendrik Bessembinder makes clear why successful stock picking is so hard.[1]

Bessembinder, a finance professor at Arizona State University, looked at every stock in the total U.S. market (as measured by the CRSP database) from July 1926 through 2015, and found that the majority of long-term stock market performance is actually driven by just a handful of stocks.

In fact, all the net market returns came from just 4% of stocks.

Over this nine-decade period, stocks returned about 11.7% annually and one-month Treasury bills returned just 3.4%, yet Bessembinder found that 96% of stocks collectively performed no better than the Treasury bills with 58% of stocks doing worse.

In fact, the most common (or modal) outcome for an individual stock during this time was a -100% return — nearly a complete loss.

With so many underperforming stocks, it is no surprise that most active managers can't find the few winners that power market returns.

And just as you shouldn't try to pick stocks, trying to time when to be in or out of the market is almost equally difficult.

From 1937 – 2016, let's look at the number of down periods (on a rolling basis) for the S&P 500.[2]

Time Frame	Positive	Negative
Daily	55%	45%
Quarterly	69%	31%
Annually	76%	24%
5 Years	89%	11%
10 Years	97%	3%
20 Years	100%	0%

Source: Daily data via Morningstar Direct, Quarterly/Annually/5/10/20 years from DFA Returns 2.0

As the chart shows, for short periods of time, especially daily and quarterly, you have a reasonable chance of actually losing money.

But if you stay invested, and don't try to guess which days, quarters or years will be up or down, your probability of positive returns increases considerably. As you can see, there has been no 20-year period when the S&P 500 has not had positive returns.

For investors, the conclusion is clear. Don't try to outguess the market or try to find outperforming managers or stocks or jump in and out of the market. The odds that you (or managers) can consistently guess right are just too low.

Instead, diversify broadly and globally and let markets as a whole work for you over the long term.

[1] *Do Stocks Outperform Treasury Bills?*, Last revised 5/22/17, Hendrik Bessembinder

[2] Source: Morningstar

All investing involves risk; principal loss is possible. Past performance does not guarantee future results. Diversification neither assures a profit nor guarantees against loss in a declining market.

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