

Client's Corner

How to Think About “The Stock Market”

ON THE ONE HAND, HERE IS A COLLECTION OF 500 OF THE largest, most soundly financed, best managed, most profitable, most innovative and most transparent companies serving America and the world at large. It's the Standard & Poor's 500-Stock Index. You not only recognize the names of these companies; you and your family purchase their products and services regularly—some as often as daily.

It is not too much to say that these companies have forged—and are continuing to forge—the American economic experience. Why does this country, with only about five percent of the world's population, produce around a quarter of global GDP? In an important way, these companies are why. Entrepreneurial shareholder capitalism is why.

Thus, you may be happy to learn that you may purchase (albeit indirectly) ownership in these 500 companies with the click of a computer. You may thereby invest your retirement capital—and the legacy you wish to leave your children, many years from now—in these companies, in the hope that they will continue to grow their earnings, their dividends and their long-term value as successful businesses.

That's on the one hand.

On the other hand, here is (and I place this concept in quotation marks very deliberately) “the stock market.”

I submit for your consideration the thesis that they are not the same thing. Indeed, I suggest that, on anything less than a long-term basis, they have relatively little to do with each other.

As a general statement, the focus of the 500 companies is on the long-term improvement of their businesses. They seek to earn progressively more net income over time by expanding and enhancing the products and services they offer, all the while taking care to keep their prices competitive. This, their highly compensated management teams know, is a marathon rather than a sprint.

To the extent that the companies as a group succeed in these endeavors, many of them are able to increase their dividends; by reinvesting those dividends, shareholders find their investment not just growing but **compounding** in value over time.

The focus of “the stock market,” on the other hand, tends to be minute to minute, day to day, month to month and quarter to quarter. Other than in the long run, “the stock market” need not, and it certainly does not, reflect the gradually advancing earnings, dividends and intrinsic values of the great companies. Instead, “the

stock market” reflects what a plurality of market participants—not infrequently stampeded into a panic attack by relentlessly negative financial journalism—is feeling about stock prices **right now**.

As someone who is investing for what may very well turn out to be a three-decade two-person retirement—and who may also be hoping to create a legacy for one's children and grandchildren—you will want to keep your focus on the long-term record of the companies. And you'll find that, over time horizons appropriate to your most cherished goals, the earnings of those companies and their stock prices have risen in very close relation to each other.

In 1970, for example, the Standard & Poor's 500-Stock Index earned \$5.51, and closed out the year at 92. As I write, the consensus earnings forecast for 2022 is around \$220, and the Index is trading near 4,200. That is, they're both up about 40 times, and not at all coincidentally: the blended values of the 500 companies have been borne aloft by their rising earnings. (With dividends reinvested, the average annual compound rate of total return in this period has been about 10.5%.) **This is how it works.**

In the interim, “the stock market” has on very many occasions been a screaming nightmare from which you couldn't wake up:

- The **average** annual peak-to-trough correction in the S&P 500 was upwards of 14%.

- The Index declined by an **average** of about a third around each of the nine U.S. economic recessions beginning with the one that started in December of 1969. (Yes, I acknowledge that at this writing the ninth and most recent episode has not yet been anointed an “official” recession by the august sages of the National Bureau of Economic Research, and I say the hell with it.)

- The Index about **halved**—as in “down an average of 50%”—**three times** (1973-74, 2000-02, 2007-09).

The choice remains yours (aided, of course, by the gentle but persistent counsel of your financial advisor). You can focus on the earnings, dividends and values of superior businesses over time horizons commensurate with your lifetime financial goals. Or you can focus at any given moment on the manic-depressive short- to intermediate-term randomness of “the stock market.”

In a very real sense, that choice will end up dictating the financial outcome of the rest of your life.

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