StraightTalk
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The Stock Market in Just 5 Numbers

It is the season of giving, and in that spirit, I am going to give each of you a package. Inside this package is the single best investment concept to keep your lifetime accumulation ahead of inflation and taxes. Since we began tracking them in 1792, owning the Great Companies of America has succeeded in growing wealth at a rate beyond the prevailing rates of inflation and taxation. Over those two plus centuries, Presidents have come and gone, inflation has been high and low – and the same goes for tax rates. Yet over time, in all those environments, owning these great companies has worked.

However, you might notice that as you unwrap this package, the inside of the gift-wrapping states that these great companies have fully lost half their value three times over the last half century! Wait…..what? How can owning these companies keep you ahead if you face multiple episodes of losing half of your capital?

Before we get to that answer, and the title of this newsletter edition – a quick history refresher. Let's hop in the StraightLine wayback machine and time travel to the first of these three "halvings," which began just over 50 years ago, in 1973. It was a difficult time in our nation's long history, a period of rapidly rising, painful inflation. That was paired with a global oil crisis, requiring severe rationing of all fuel use, especially at the pump. Corporate earnings had also slowed, and the scandal of Watergate threatened the very foundation of our government. The markets, quite predictably, sold off by half over that two-year period.

Fast forward to a more recent market panic, the tumultuous period of 2000-2002. We entered that period riding a five-year high of stocks surging on the promise of the internet and e-commerce changing our lives forever. What ensued was a three-year period that saw the bursting of the dot.com bubble, the World Trade towers falling in the horrific national tragedy of 9/11, and numerous financial accounting standards, in which one of the world's largest accounting firms collapsed due to accounting scandals. As a result of these fraudulent accounting practices, market participants concluded they could no longer believe in any published earnings numbers, and predictably rushed to sell, dropping markets by half during this period.

Which brings us to the one we can all remember easily, the Global Financial Crisis. This period, which began in late 2007, saw the credit system of the entire planet cease to function due to the complete breakdown of the financing of American housing. Two decades of increasingly irresponsible lending practices, combined with excessive leverage in the financial services sector, threatened to take the entire system down. There was actually a moment in 2008 when there was effectively no money to be lent by anyone, to anyone, on any terms. Of course investors fled the markets in droves, and by spring of 2009, the market was down by more than half.

So, we have witnessed three episodes of 50% price declines…which sounds scary now, but of course, living through them was significantly more so. Those facts having been established; I now have a question for you. Let's assume you had invested $100,000 of your hard-earned money in the market in January 1973, just before the first of these three big declines. Using the S&P 500 as a proxy, what do you think that investment would be worth today, assuming dividends were reinvested? Don't look it up - just guess...

The answer is a bit more than $20 million. You read that correctly. At a compound rate of almost 11% during those five decades, *had you ignored the news and noise,* your $100,000 would have gone on to rise 200-fold. Hence the title to this newsletter

edition – we can express the stock market in just those five numbers, 50%, 50%, 50%, 100K, and 20M. Three 50% corrections, and $100,000 turns into $20 million. I should have a t-shirt printed up with 50, 50, 50, 100K & 20M on it!

If five decades ago is too far back to be relevant to your time frame, then let's just focus on the time from the eve of Y2K up until now. A $100,000 investment on that New Year's Eve left alone to compound, would be worth more than $600,000 today. This sixfold return over the last quarter century is due to a slightly lower compound than the long-term average, "only" 7.6% per year. (The fact that the last two and a half decades have had a return below the long-term average should make a patient investor optimistic about the next two decades, since the most powerful economic law is reversion to the mean…but I digress.)

However, it is important to note that in addition to the previously discussed halvings, this past quarter century also included the fastest drop ever from an all-time high to a bear market. In just 33 days, the stock market fell 34%, as our economy was shutting down during the onset of COVID. Additionally, during 2022, as the chickens of the Covid over-stimulus came home to roost, the excess money in our economy sparked the first real inflationary fire since the 1970's, and the stock market fell 25% in nine months.

The simple fact is that this last quarter century, with all its bad news and difficulties provided a six-fold increase in your capital, while inflation barely doubled over that period. *Even in a below-average growth period, owning the great companies protected you from the double threats of inflation and taxation.* Of course, this quick math does not include the cash dividend from those great companies, which grew by four and a half times during that quarter century. Whether you chose to use the dividend as income for your life, or to reinvest it back in your portfolio, just the dividend kept you ahead of inflation, and the sixfold increase in value was therefore a bonus. I don't think the news reported this story nearly often enough.

So, I have a corollary question to this discussion. How many of the investors who panic sold their shares of the great companies during the three half-off sales reached that $20 million compounding result? The answer, of course, is zero. Once you give away your shares to someone else at sale prices, you inevitably must buy them back in the future at a higher price, which changes your return dramatically for the worse. By definition, doing so increases your invested cost and reduces your return, but even more importantly, means that you miss out on the time element of compounding. Warren Buffet's lifetime partner, Charlie Munger, said it best, *"the first rule of compounding is to not interrupt it unnecessarily."*

We all know the tone of the news is always negative, and we all know why. During periods of relative prosperity, it is easier to ignore this negative tone, but when the challenging periods arrive (and they will arrive) in the future – it will become imperative to tune the negative noise out. This is my package – you cannot sign up for the lifetime wealth creation from the Great Companies without enduring the noise of the prices of stocks. Indeed, this is the inherent bargain of being lifetime owners of the Great Companies. It goes without saying that they became great, and can stay that way in the future, by figuring out a way through those challenges, whatever they may be.

As an aside, the big events are usually perceived as negative; things like Covid, the Great Financial Crisis, and 9/11. However, the defining black swan of the last three decades – the thing nobody saw coming – was the Internet, which fundamentally changed life on our planet (mostly for the better.) We can't possibly know or see the next positive black swan coming, but as optimistic investors, we must know one will surely come.

Remember, the miracle of compounding does not always win in shorter periods of time, but over time, it wins by such a large margin that you forget the existential crises that occurred along the way. All the noise and negativity of the last five decades can be reduced to 50, 50, 50, 100K and 20M. Try to keep that in your mind when you hear the next news crisis.

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