Investing's Mythical Bullseye

Saturday's With Jim

By Jim Pursley
President and CIO, Gaia Capital Management, Inc.
www.gaiacapital.com
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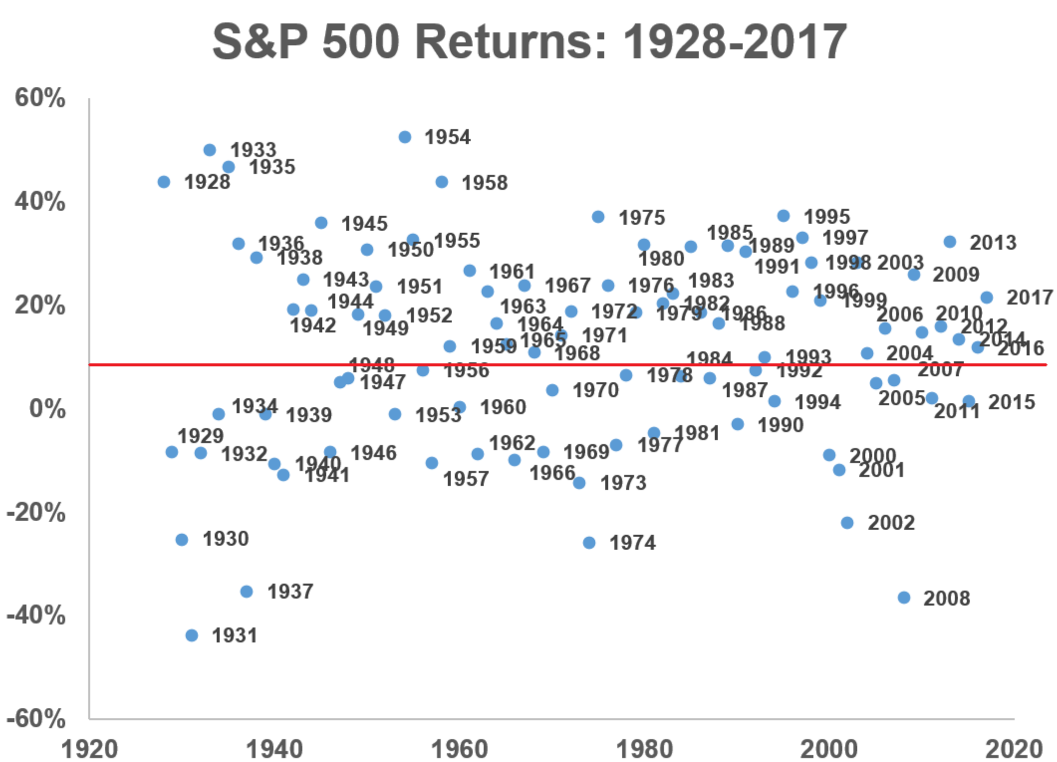
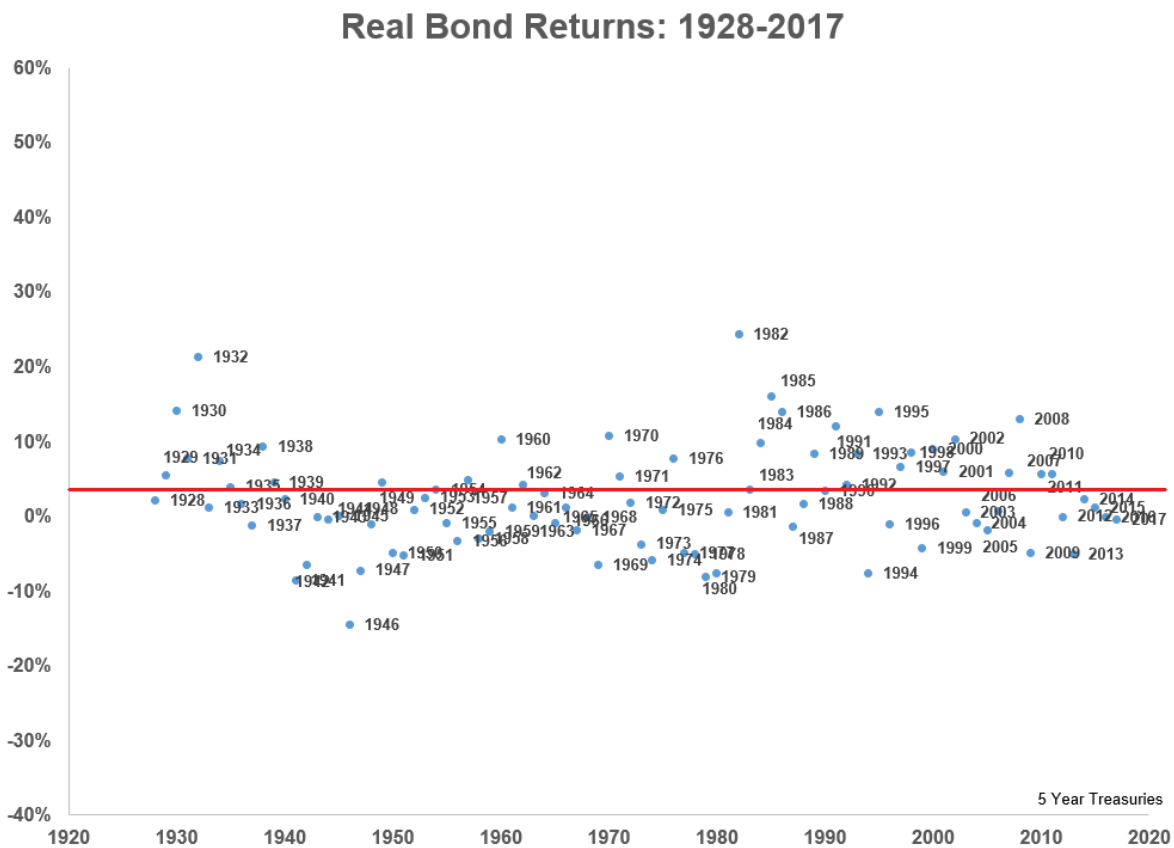
Dear Friends,

The bullseye in archery is the archer's holy grail. The bullseye in investing is the long-term return. Both are hard to hit, while in investing the bullseye is almost never hit in a given year. It doesn't take much expertise for the investor archer to get near the bullseye with bonds, especially shorter-term ones, but the archer aiming at the bullseye for stocks might as well be blindfolded. The following two charts, from Ben Carlson's blog, *A Wealth of Common Sense, on July 27, 2018*, show annual after inflation returns (each year's return as a dot plotted against the horizontal and vertical chart axis) of the S&P 500 and 5 year Treasury bonds:





As you can see, the returns for stocks are scattered widely about while the returns for bonds are more closely concentrated near one another. Viewed from an annual lens, it's hard to visualize the average after inflation long-term return of stocks, which is 7%, and 2.2% for bonds. It's also hard to predict future returns based on past ones. We can, however, use current market valuations (price compared to some attribute of stocks like their earnings) to predict returns up to perhaps seven years out. If our starting valuation is very high, as it was in 2000, the coming period's returns are likely to be subdued. Conversely, if valuations are relatively low, the coming period's future returns should be robust.

Practical Application

The reward for owning stocks goes to those with the endurance to hold them.

The biggest reward goes to those who know what they need and invest accordingly, with a plan in place. Most people will want to set a mix of stocks and bonds to fit their needs, capacity and relative feelings about loss and gain. It is this mix, and the diversification they bring, that powers the long-term return IF it is not tampered with beyond what their rules permit. In other words, if we can leave emotions out of investment decision making, calm judgment will likely strengthen our results.

Thank you for investing with us.