The Washington Post

Business

For investors, an ugly three months after 10 very good years

By Thomas Heath
December 21

The numbers are cosmic.

From the depths of the Great Recession in March 2009 through September of this year, the shares of the 500 largest public U.S. companies grew by $18.9 trillion.

In addition to the rise in stock prices, those 500 businesses delivered $3.1 trillion to their shareholders in the form of dividends.

Add them up, and by September 2018, the total comes to more than the entire $21.9 trillion of federal debt.

“The greatest amount of wealth creation in history” is what Howard Silverblatt of S&P Dow Jones Indices called it.

Then — well, you know: It’s been an ugly three months.

The S&P has dropped 16 percent, taking $3.7 trillion in wealth from shareholders and reducing the 10-year bull market gain to $15.3 trillion.

But even including the losses this month, one of the worst Decembers for stocks since the 1930s, investors are way up compared with a decade ago.

Markets have been whacked repeatedly in recent weeks — by a Federal Reserve quarter-point rate hike, a roiling U.S.-China trade spat, oil prices declining because of worries about world economic growth, and, finally, a White House threat to close the government over funding for a border wall between this country and Mexico.

It’s not easy for investors to look at the bright side.

“While you are still doing well, you paid a $3.7 trillion hit in the last three months,” Silverblatt said. “The main question now is, Is that all of the payback? If so, sign me up again. But if it’s the start of a bear market, the bottom line is, investors need to look at their holdings and decide whether to buy, hold or sell.”

For some, the answer is this simple: Keep your head down. Stay in the stock market. And don’t pay attention to the day-to-day news.

“There is always going to be something to worry about,” said Daniel P. Wiener, chairman of Adviser Investments. “You want a list? Government shutdown. Tariffs. Brexit or no Brexit. White House investigations.

Oil prices. Growing budget deficits. Growing national debt. Federal Reserve policy. Johnson & Johnson and asbestos.

"But," he said, "history shows that in the long scheme of things, these short-term blips are footnotes to the wealth production that the stock market generates."

From January 1926 through September of 2018, the S&P 500 gained an average of 10.29 percent a year in total return, including dividend reinvestment, according to Silverblatt.

Not everyone tunes out the noise. Many investors are worried that the best days are in the past — at least for the foreseeable future.

Fewer than 40 percent of Americans expect the stock market to grow in the next year, according to a survey of 1,300 households by the Federal Reserve Bank of New York. That is the gloomiest outlook for stocks in the Trump era.

Retail investors are the gloomiest they have been in more than five years, according to the American Association of Individual Investors survey released a week ago. The 48.9 percent of respondents who think the S&P 500 will lose ground is the highest since April 2013.

Mutual funds and exchange-traded funds investing in U.S. equities reported $25.2 billion in net outflow from Oct. 1 through Dec. 12, more than twice the rate of the same period a year ago, according to the Investment Company Institute, which represents the mutual fund industry. But the 2018 figure is a tiny fraction of the $10.3 trillion held in all domestic equity mutual funds and ETFs.

"Investors are reacting moderately to market volatility," said ICI chief economist Sean Collins. "This is consistent with the type of behavior we've seen for decades from fund shareholders who stick to their investment plans and asset allocations and remain focused on long-term financial goals."

But, in fact, said Francis Kinniry, a principal of the Vanguard Investment Strategy Group, the market is doing much better than the headlines indicate. He said investors should keep an eye on the $15.3 trillion, remember that they are up in the past decade and try to forget the recent slide.

"We are 12 percent off an all-time high," Kinniry said. "The reader needs to be immune to the points. Just look at percentages. We have people say, 'Just look, the market is down 800 points.' But 800 points in a Dow that is at 23,000 and a Dow that is 1,000 or even 10,000 is a lot different. We really have to start looking at percentages instead of points."

Furthermore, Kinniry said, people need to understand that markets fluctuate.

From January 1980 until the end of last year, stocks went through eight bear markets lasting at least two months. A bear market is a decline of 20 percent or more from recent highs. There were also 11 corrections in that time. A correction is defined as a decline of 10 percent from recent highs.

"Markets do not go straight up," Kinniry said. "When they go down, it's a normal event."

When the market does go up, it tends to go up the most in just a few days each year. The worst and best days are usually lumped close together, according to Vanguard.

The risk for investors, whether one is a 30-year-old saving for a home or 60-year-old on the cusp of retirement, is staying out of the market because of fear.

Missing out either way means paying a big opportunity cost — or the losses you incur from doing one thing instead of the other.

"If you were too conservative, you missed out on this giant bull market of the last 10 years," Kinniry said. "The right asset allocation is balancing regret that you do not have more in equities when the market is doing well with remorse when you have too much in the equities when the market is going down. It is a balancing act."

Stocks aren't that expensive, even with the big advance over the past decade. In fact, they are cheaper, all things considered, than they were in 2007 when the Dow Jones industrial average of 30 of the most important U.S. companies was at 14,000.

"Investors must look beyond the share price to the underlying earnings power and financial strength," said D.C. investor Michael K. Farr. "Corporate earnings and the U.S. economy are expanding. Higher earnings and better prospects for earnings growth justify current trading levels. While the short term can be volatile, increasing earnings should drive prices over time."

For example, the companies in the S&P 500 increased operating income 29.7 percent for the 12 months that ended Sept. 30, compared with the previous 12 months. And the average price-to-earnings ratio of the S&P 500, a common metric for deciding whether a stock is cheap or expensive, is 17.6. That is down significantly from 21.2 last year.

"The market is having a tantrum," Farr said. "We have had a steady sugar fix from the Fed, and now the Fed is cutting the frequency of the sugar. The child is having a tantrum."

Farr added that the economy is still fundamentally strong.

"This is not a bubble. Inflation is low, and 20 percent of the S&P 500 is trading at eight times earnings," Farr said. "These are not levels at which markets crash. Don't despair. Things are still improving. Slowly."

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