A Tale of Two Decades: Lessons for Long-Term Investors

The first decade of the 21st century and the second one that's drawing to a close have reinforced for investors some timeless market lessons: Returns can vary sharply from one period to another. Holding a broadly diversified portfolio can smooth out the swings. And focusing on known drivers of higher expected returns can increase the potential for long-term success. Having a sound strategy built on those principles – and sticking to it through good times and bad – can be a rewarding investment approach.

Looking at a broad measure of the US stock market, such as the S&P 500, over the past 20 years, you could be forgiven for thinking of Charles Dickens: It was the best of times and the worst of times (see **Exhibit 1**). For US large cap stocks, the worst came first. The "lost decade" from January 2000 through December 2009 resulted in disappointing returns for many who were invested in the securities in the S&P 500. An index that had averaged more than 10% annualized returns before 2000 instead delivered less-than-average returns from the start of the decade to the end. Annualized returns for the S&P 500 during that market period were −0.95%.

Yet it was a good decade for investors who diversified their holdings globally beyond US large cap stocks and included other parts of the market with higher expected returns—companies with small market capitalizations or low relative price (value stocks). As **Exhibit 2** shows, a range of indices across many other parts of the global market outperformed the S&P 500 during that time span.

> *Looking at the US stock market since the turn of the century, you could be forgiven for thinking of Charles Dickens' famous words.*

The next nine-plus years reveal quite a different story. It has looked more like the best of times for the S&P 500, as the index, when viewed by total return, has more than tripled since the start of the decade in the bounce-back from the global financial crisis. US large cap growth stocks have been some of the brightest stars during this period. Accordingly, from 2010 through the first half of 2019, many parts of the market that performed well during the previous decade haven't been able to outperform the S&P 500, as **Exhibit 3** displays. Since many of these asset classes haven't kept pace with the S&P, these returns might cause some to question their allocation to the asset classes that drove positive returns during the 2000s.

It's been stated many times that investors may want to take a long-term view toward investing, and the performance of stock markets since 2000 supports this point of view. Over the past

Exhibit 1: S&P 500 (Total Return)
January 2000–June 2019, monthly levels

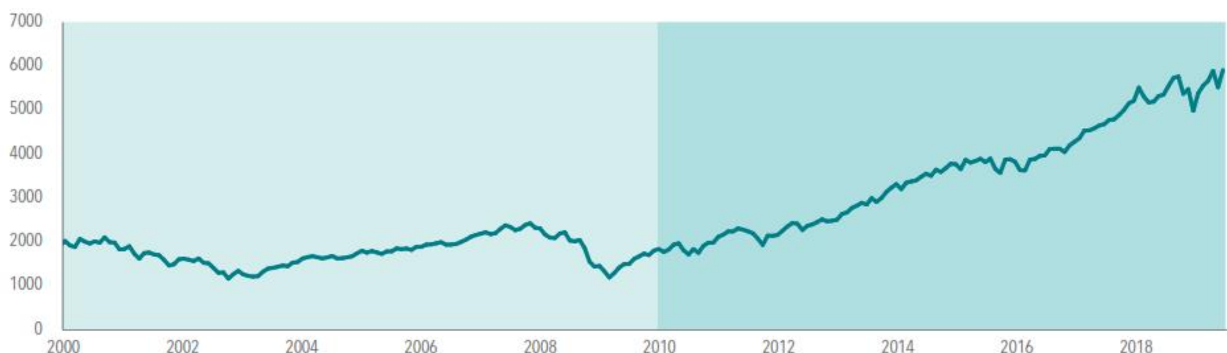
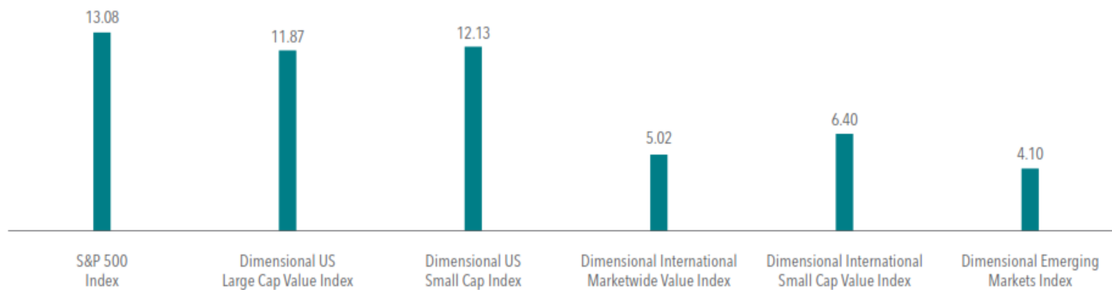


Exhibit 2: The 2000s

Annualized returns (%): January 2000–December 2009

Exhibit 3: The 2010s

Annualized returns (%): January 2010–June 2019

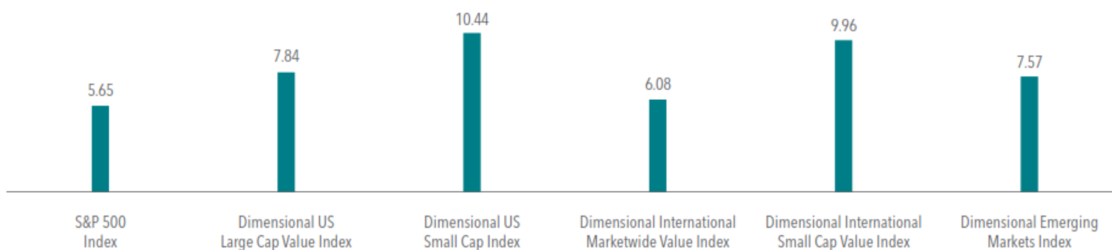


19½ years (see **Exhibit 4**), investing outside the US presented investors with opportunities to capture annualized returns that surpassed the S&P 500's 5.65%, despite periods of underperformance, including the most recent nine-plus years. Cumulative performance from January 2000 through June 2019 also reflects the benefits of having a diversified portfolio that targets areas of the market with higher expected returns, such as small and value stocks. And it underscores the principle that longer time frames increase the likelihood of having a good investment experience.

No one knows what the next 10 months will bring, much less the next 10 years. But maintaining patience and discipline, through the bad times and the good, puts investors in a position to increase the likelihood of long-term success.

Exhibit 4: 2000–2019

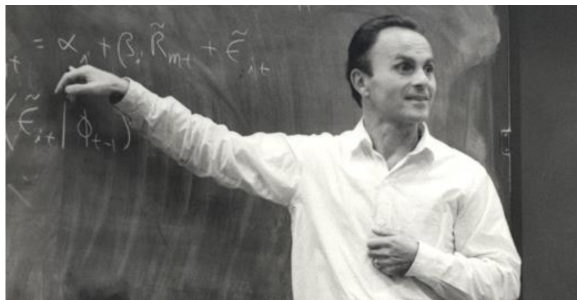
Annualized Returns (%): January 2000–June 2019



Concerned About the Yield Curve? Don't Be!

They're back at it again. In a recent paper, Eugene F. Fama and Kenneth R. French, both board members of Dimensional Fund Advisors and Fama a Nobel laureate, research whether an inverted yield curve predicts low stock returns. Before we jump to the conclusion, let's remind ourselves of what the yield curve is and how it is viewed in the investment world. The yield curve plots the term of the bond on the X axis and the expected return of the bond on the Y axis. What this shows is the expected return for a given bond.

Typically, investors expect to receive higher returns for longer-term bonds; that is, higher return is necessary to compensate investors for assuming additional risk. Market prognosticators use the yield curve, or try to, to predict the direction of the market and the economy in general.



So back to Fama and French. Their conclusion on whether we can reliably use the yield curve to predict stock returns is a resounding *no*. Testing monthly stock and government data for the United States and 11 other major markets, and going as far back as 1975, Fama and French concluded that "yield curves do not forecast the equity premium." They compared a speculative strategy of replacing the US stock portion of a portfolio with one-month Treasury bills when the interest rate spread is negative with a strategy of holding the US stock market and not selling during inverted yield curves. (They also examined the effect using world markets, but as the results were the same, we'll stick with the US here for simplicity.)

In 67 of 72 scenarios, investors' expected returns were reduced by following the speculative strategy.

In 67 of 72 scenarios, investors' expected returns were *reduced* by following the speculative strategy. Put another way, investors who try to increase their expected return by shifting from stock to bills after inversions are instead sacrificing the positive expected equity premium – that is, the historical outperformance of equities over bonds.

Here at Rockwood, we use research to thoughtfully design investment portfolios. This study is yet another reminder to stay focused on the long-term upward trajectory of the global equities markets and to maintain discipline even when – no, *especially* when – markets are volatile. Please do not hesitate to give your advisory team at Rockwood a call if you have any questions or simply wish to understand this concept further.

Rockwood Adds to Its Growing Team

This past summer was a busy one as we welcomed Najeedah Ghias, Alaina Masler, and Renee Schuster to the Rockwood team.

Najeedah Ghias, a Financial Planning Associate, graduated from Temple University in May, where she double majored in Financial Planning and Risk Management and Insurance. Najeedah is a Bucks County native who is passionate about the outdoors. In her spare time she rides horses, teaches new riders, and trains rescue horses at Sommerfield Stables.

Alaina Masler, a Private Client Advisor, brings a decade of experience in financial services and nonprofit work to her role at Rockwood. A graduate of Lafayette College with a degree in Economics & Business and Spanish, she honed her wealth management skills at Market Street Trust Company, a multifamily office in upstate New York. In her free time, Alaina enjoys running and playing the saxophone and piano.

Renee Schuster, CFP®, a Private Client Advisor, most recently worked as a financial planner at TIAA-CREF, working with employees of education and nonprofit institutions. She has a degree in Corporate Finance and Economics from James Madison University. Renee enjoys spending time with her family at the beach in the summer and at the Poconos in the winter.

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