Wealth Management

The Crescent Group

RBC Wealth Management

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What does it mean to invest for the long term? Most investors have heard that it's the best way to invest in order to succeed at their financial goals. Over the decades, prominent investors such as Warren Buffett, Carl Icahn, Peter Lynch, and many others, have advocated for long-term investing. Yet while most people know that they should focus on the long term, doing so has become increasingly difficult in a world with minute-by-minute news updates that come in the form of sensational headlines.

Most investors understand the big picture rationale for long-term investing. Retirement typically lasts decades, and many people invest not just through retirement, but through the majority of their working career. Investing to optimize one's gains over a five-year period doesn't make much sense when what they actually need to do is optimize their gains over thirty, forty, or even more years.

The part where investors often go wrong with long-term investing is that it requires an investor to stick with a proven long-term investment process, even if it's temporarily out of favor. Over short periods of time, one asset class can outpace the others. For instance, during an economic contraction, bonds would likely outperform stocks over a short-term time period. But what matters for maximizing long-term returns isn't which asset class or investment process temporarily performs better. What matters is which asset class or investment process will perform better over the entirety of one's lifetime.

Determining where an investor will likely find the best return over their lifetime does not require guesswork. Very smart researchers have dedicated their lives to calculating the long-term returns earned from different asset classes. Jeremy Siegel, Professor of Finance at the University of Pennsylvania, has calculated long-term returns for U.S. stocks, U.S. bonds, and gold. Siegel's recent publicly available data cover the time period January 1802 to December 2010. Over that time period, the approximate annual returns have been 7% for U.S. stocks, 4% for U.S. bonds, and 1% for gold. So stocks have strongly outperformed bonds and gold over the long-term, and we expect that to continue into the future. That's not to say that investors shouldn't own bonds. For our clients living off their assets in retirement, we maintain three to five years worth of living expenses in bonds and cash, so that when the stock market does stumble from time to time, they have a stable source of assets to live off of until the market recovers. But we continue to keep an appropriate

portion of these clients' assets invested in stocks in order to overcome inflation and taxes[1].

A quick aside on inflation and taxes: inflation sounds harmless and doesn't generate sensational headlines. But in the U.S., inflation has cut the value of your assets in half every twenty-five years. So if you retired with $1,000,000, that value became $500,000 twenty-five years later. If your assets generated $100,000 per year at retirement, they only generated the equivalent of $50,000 twenty-five years later. We expect similar rates of inflation in the future for the U.S. No one knows what will happen with tax rates, but if they increase, that's another burden that one must overcome to maintain purchasing power and wealth[2].

What about real estate? The world's foremost authority on U.S. home price appreciation is a man by the name of Robert Shiller. He won the Nobel Prize for Economics in 2013 and is Professor of Economics at Yale University. Shiller has spent his career studying U.S. home prices. He co-created an index known as the Case-Shiller Index, which has tracked long-term U.S. home prices since 1890. It turns out that over the long term, U.S. home prices have appreciated about 3% per year. Of course residential real estate also comes with outsized costs, such as insurance, taxes, maintenance, and mortgage interest. There are also specific risks involved that many investors think about with stocks but not with their hometown real estate, such as a lack of geographic diversification (just ask people who bought properties in Florida or California in the mid 2000's), lack of liquidity, and volatility (now that prices have gone straight up for several years, many people have forgotten what happened in 2008)[3].

So according to peer-reviewed, authoritative, long-term data, stocks have outperformed the other major investment asset classes over the long-term. This means that remaining committed to optimizing one's long-term investment returns means remaining committed to stocks, even when they temporarily underperform. Some investors may be tempted to shift their assets out of stocks and into other asset classes when stocks temporarily perform poorly, but the data show that doing so does more harm than good. For example, DALBAR has conducted the foremost studies of investor behavior over the past twenty-five years. According to DALBAR's most recent annual report, two behaviors have caused investors to earn lower returns than they should over time: (1) moving into and out of investments too frequently and (2) trying to time the market. For example, over the past twenty years, DALBAR reports that the average investor in a 50% blend of stocks and bonds earned a 2.6% annual return. That compares to a 5.9% return if they had simply held a blend of stocks and bonds. DALBAR concluded that the shortfall in investors' results came from investors losing patience and shifting assets from one type of investment to another, as well as trying to time the market[4].

Remaining committed to stocks over the long-term sounds easy when times are good, but sticking with stocks during lackluster or tough times for the stock market requires an investor to have confidence in the process that guides their investments. The investment process that our Group follows was pioneered by Warren Buffett's mentor, Ben Graham, more than one hundred years ago. Many of history's most successful investors have employed Graham's investment approach with great success over the past one hundred years. We expect such an investment process to continue to generate strong investment results in the future. Our Group limits our investments to those with a demonstrated track record of generating profits and cash flows over a long period of time. We stay away from unproven companies and industries, or those with only a short-term track record of success. We do this so that when financial markets do fall apart, as they are guaranteed to do from time to time, our clients can have confidence in the process that guides their investments. This increases the likelihood that our clients will remain invested in stocks for the long-term and succeed with their financial goals – and maximize the enjoyment of their lives![5]

Best Regards,

The Crescent Group
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Sources:

(1) Siegel, Jeremy, Stocks for The Long Run
(2) Bureau of Labor Statistics
(3) Shiller, Robert, Irrational Exuberance
(4) DALBAR
(5) Carlen, Joe, The Einstein of Money

Past performance is not indication of future results.

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