Wealth Management

The Crescent Group

RBC Wealth Management

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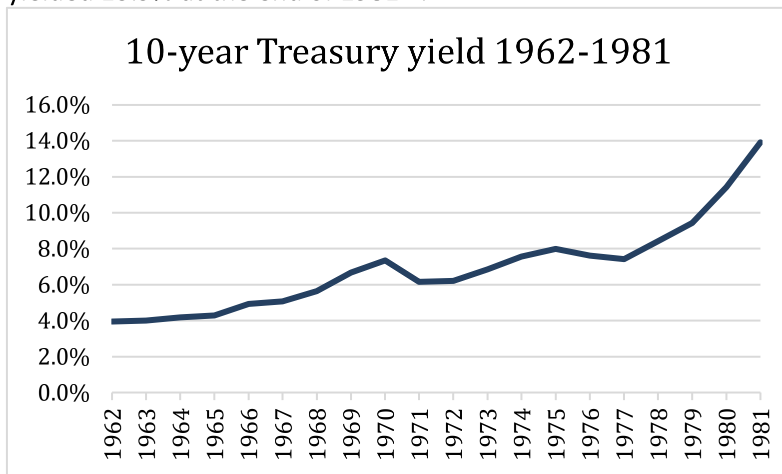
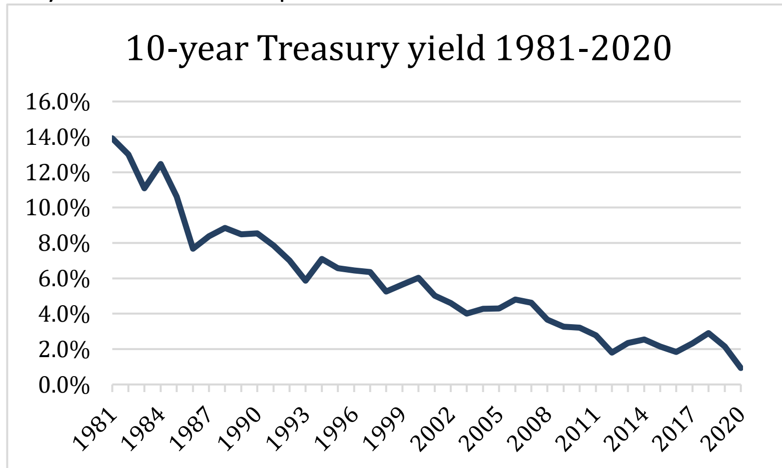
October 2021 Crescent Commentary

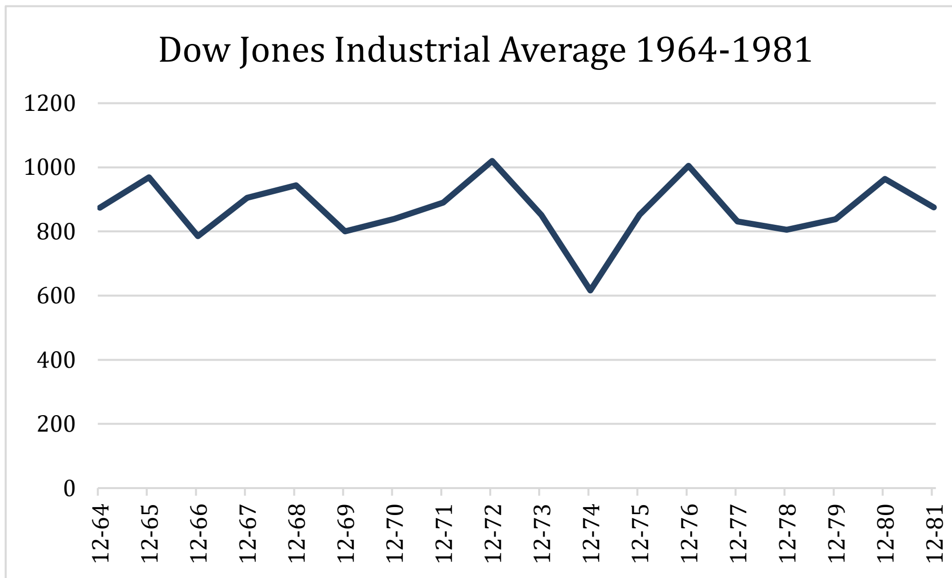
What happens when the rules of the game change? Over the twenty years ending 1981, interest rates in the U.S. moved higher, reaching their peak in September 1981. As a result of those interest rate increases, investors had suffered twenty years of losses from investing in bonds, as well as stagnant stock returns. Almost everyone expected interest rates to remain at high levels or move even higher, with further losses from bond investments. The 10-year Treasury bond yielded 13.9% at the end of 1981[1].



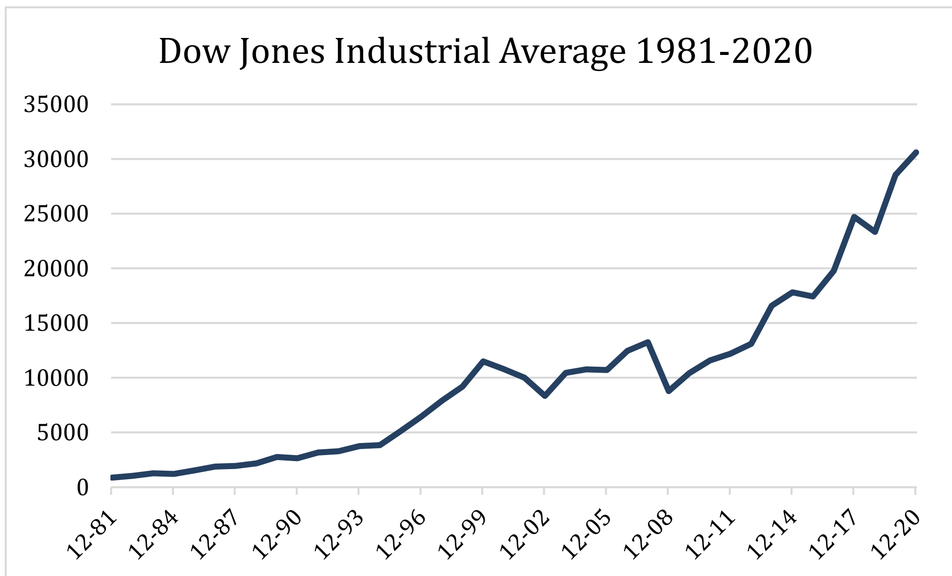
Virtually overnight, the world changed. In 1981, interest rates began a decline that lasted forty years, and no one saw it coming. The 10-year Treasury ended 2020 with a 0.9% yield and bond prices experienced a 40-year bull market of price increases instead of further losses[1]:



From 1964 to 1981, partly as a result of the increase in interest rates, and partly as a result of overvaluation of the most popular investments of that era (auto and airline companies sure to revolutionize the world—sound familiar?), the Dow Jones index was flat for 17 years. After nearly 20 years of doing nothing, investors expected stocks to continue to do nothing[(2)(3)]:



But instead, the Dow increased forty-fold over the next forty years. No one saw it coming:



Investment markets have a history of laughing at our expectations. Investments or trends that have led to easy profits for ten years or longer can and do change overnight, leaving investors nursing losses and swearing off future investment attempts. For several years following the 2008 financial crisis, investors had low expectations from their investments, and many investors wouldn't invest in stocks. Fast forward 13 years to today, and most investors seem to have a feeling of exuberance, with many market participants speculating, gambling, and falling over each other to chase after what has gone up the most. At some point, this will change. As the charts above show, it can happen suddenly and with almost no one expecting it.

Given the unpredictability of the future, and given that popular trends have historically failed and ended in tears, how should you invest your irreplaceable wealth today? For one thing, you need to stick with investments that have withstood the test of time. Companies that provide products or services that people have used for hundreds of years, and that are unlikely to face technological obsolescence, are a good place to start. These investments tend to face neglect during times of euphoria such as the present, but long-term data show they are the true stars of investing. For the 42 years ending 2009, the Consumer Staples industry (food, beverages, consumer personal care and household products) generated the highest annual return among all

industries. This is likely due to the power of their brands (most have increased prices 5% to 10% this year), and the fact that their products are used for daily activities of life in both good times and bad, which leads to stable cash flows. Information Technology, currently the most popular investment industry, was the worst performing sector. That's probably because of technological obsolescence that batters the industry over time[4].

The stable cash flows generated by strong consumer brands have withstood the test of time. But what happens if U.S. stock markets experience long periods of no return, such as 1929 to 1954 (Dow flat for 25 years), 1964 to 1981 (Dow flat for 17 years), or 2000 to 2013 (S&P 500 flat for 13 years)? Well, during time periods like those, dividends become even more important. For example, on December 26, 1972 and October 26, 1982, the Dow closed at exactly the same level. Most investors think that if they had a million dollars invested in the Dow over those ten years, it would have remained one million dollars. But if you reinvested your dividends over that time period, you actually would have had $1.7 million at the end of those ten years. Dividends aren't the most exciting form of investment in times of exuberance like the present. But dividends matter. How many investors today had any significant sums of money invested in the 1970s? Almost none. So it's understandable why we see so many investors throwing all risk controls out the window right now and falling over each other to chase what's popular. But our Group has studied history and we are aware of the importance of dividends over the long term, and we invest our clients' assets accordingly[5].

The point of the charts we showed at the beginning of this commentary is not to expect the future to look like the opposite of the past ten or twenty years. No one can predict that. The point of the charts is to invest today in a manner that gives you the best chance of doing well when the unexpected happens, because the unexpected will happen. Our Group will continue to do that for our clients.

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Sources:

(1) Board of Governors of the Federal Reserve System
(2) S&P Dow Jones Indices LLC
(3) Fortune
(4) What Works on Wall Street, 4th Edition
(5) Roger Thomas

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