May 2009 *MoneyMinute* – Myths of Market Underperformance

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A bear market, especially one as severe as this one, creates many opportunities for misinformation. In this *MoneyMinute,* I offer some corrections.

Even in rising markets, investors are inundated with outrageous data from the bulls. For example, a phrase like "the world has changed forever" was spewed around during the technology/internet bubble in the late '90s through early 2000, and the bestselling book *Dow Jones 36,000* was published in 1999.

In down markets, the communications are even more outrageous, with the recent book *The Great Depression Ahead* as a good example. While most members of the media strive for accuracy in reporting, unfortunately much of the data are based on flawed analysis of past stock market performance. We will examine three common misleading claims about investing results that you may have heard recently.

1. Investors made no money in the market from mid '60s to early '80s.
2. It took 25 years to recover from the market peak made in 1929.
3. When inflation is taken into account, investors lost money for long periods of time.

Mid '60s to early '80s
A recent *Newsweek* cover article informed us that the market was lower in 1982 (Dow around 875) than in 1966 (Dow at 969). There are three big flaws in this assertion.

1. The Dow Jones Industrial Index (only 30 stocks) is not very representative of the stock market as a whole.
2. Dividends are ignored.
3. The worst intervals are cherry-picked.

Using the S&P 500 (much more representative of the stock market) with dividends reinvested, the returns from 12/31/1965 to 12/31/81 were about 152% (6% per year). That's not a great return, but it sure beats losing money. If we move the measurement just one year in both directions, the returns were 198% for 12/31/64 to 12/31/80, and 240% for 12/31/66 to 12/31/82.

Ignoring dividends is a very common flaw in almost any return reported by the media. As you can see, leaving out the dividends leaves out a lot of the return.

The Great Depression
It took until 1951 to recover from the Great Depression? Only if you torture the data! Another flaw overlooked by the media is inflation and *deflation*. After deflation and dividends are taken into account, a lump sum investment in the average stock at the peak in 1929 would have been back to break-even in 1936, 4.5 years after the market low in

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1932. For an excellent article on this era:
http://www.nytimes.com/2009/04/26/your-money/stocks-and-bonds/26stra.html

Stocks lose money after inflation
In 1959 the Dow was 679, and in 1979 it was 899. Adjusted for inflation, the Dow was at 344 in 1979. A flawed analysis would report that investors lost money after inflation. Looking at a more representative index (S&P 500) and reinvesting those valuable dividends, we determine a total return of 275%. Adjusting for the high inflation of the era brings our return down to 43% (about 2% per year). This is a puny return for sure but it compares really well to losing half your money, as reported by the flawed research.

As we all know, stocks are not always a safe and rewarding experience. Despite overwhelmingly positive returns during long periods in the U.S., some time frames are going to be difficult for investors. Keep in mind, though, there are many advantages of using stock investments:

- very high liquidity (can be turned into cash in a few days)
- participate in the returns of our productive economy
- protect investors from long-term inflation (cash has not done that)
- wide diversification can be maintained easily with low-cost, passively managed mutual funds

As always, past performance is not predictive of future performance. The future is always an unknown, but a guide to the future is understanding what happened in the past. Just make sure the data you depend on is complete and accurate.

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