geo@oncoursefp.com 425-861-9997

Just Do It!

One common question asked by people who have received a cash windfall is whether the stock portion should be invested all at once or over a predetermined period of time, such as quarterly investments over one year. Human nature being what it is, when times are good and stocks are in the green, “all in now” is the preferred option. But when things look grim and stocks are in the red, the “little bit at a time” strategy is preferred. The stock market is the only place where, when there’s a big sale, people run for the exits.

According to Vanguard data, the S&P 500 has had a positive, real (inflation adjusted) return in 70% of rolling 12-month periods since 1928. If you adopt the one-year periodic investment strategy, you are making a bet that has failed 70% of the time and opening yourself up to the conflicting emotions that will accompany this decision. If the market rises during your delay, you’ll be angry at yourself for being timid. On the other hand, if the market goes down, you will be angry at yourself for putting money in the stock market in the first place (“I knew it would keep going down!”) and probably won't resume your planned investment schedule until things "get better”.

The biggest flaw in the “little bit at a time” strategy is that it doesn’t provide protection from stock market declines. The “all in now” investor and the “little bit at a time” investor both assume the same risk - that the day after the money is fully invested, stocks might suffer a steep decline. The “little bit at a time” strategy is a classic example of doing what intuitively feels right but which will likely turn out to be counterproductive. It's market timing hiding behind the mask of prudence.

Here’s my recommendation for investing a lump sum. The stock market has no memory; the best guess of future returns is not what has happened recently, but what has happened over the long-term. The economy can't be forecast. The stock market cannot be timed. The time to buy stocks is when you have money to invest for the long-term and the time to sell stocks is when you need the money for something more important. Everything else you read or hear on this subject is commentary, likely self-serving, not worth listening to, and likely to lead you astray.

Time, Distance and Language

Every Sunday, teams in the National Football League play a zero-sum game, meaning that for every winner there is a loser. The victorious teams profit at the expense of their opponent. Active investing is a zero-sum game. Simply put, the winners’ profits come from the pockets of the losers. Human interaction is not a zero-sum game. When people get together to discuss their ideas the interaction leaves each participant a little wiser. This is the secret to progress and technical advancement, and it makes human interaction a positive sum game.

Historically there have been three major hindrances to human interaction –- time, distance and language. The jet transport age began in the late 1950s and has pretty much eliminated distance as a hindrance to progress. Today you can travel from your home to almost anywhere in the world in less than 24 hours. Recent technological advances have made long distance travel almost unnecessary. While we weren’t looking, the world has been connected wirelessly making instant video and voice communication a reality -- at no cost. This was unthinkable just a few years ago. The days that time and distance can hinder human progress are rapidly coming to an end.

Now it seems that the language barrier is about to fall. I am “writing” this newsletter using voice recognition software which converts speech to text. The words I speak into the microphone are transformed into text on my computer screen. Recently, I engaged the services of a dishwasher repairman, a Russian immigrant with limited English language skills. When he wanted to tell me something, he spoke Russian into his iPhone and Siri spoke back to me in English. A de-babbling app. This was unthinkable just a few years ago.

As I have mentioned many times in this newsletter, pessimism is counterintuitive. To be a pessimist one has to believe that science, technology, and the unique combination of personal freedom, innovative genius and entrepreneurial energy that have been hallmarks of the American experience are all spent forces. The truth is that there is no historical evidence for this odd notion; rather history refutes it. The primary factor driving today’s global innovation is the internet -- which allows people around the world (at least those whose governments don't limit access) to share information in real-time, dramatically increasing our collective productivity. The benefits that will come from this real-time interaction are impossible to imagine today. For starters I'll assume that the technological advances in the 21st century will be the 20th century times 25. Even this may not be optimistic enough.

History reveals an amazing march of progress. Every morning 8 billion people wake up around the world and try to make the best economic decisions they can for themselves and their loved ones. Governments have an almost unlimited capacity to interfere with those decisions, but they cannot change human nature. Profit seeking companies, irrespective of government irrationality, will respond to conditions as they find them and the best will continue to prosper by developing new products, expanding the market for those products and manufacturing them more efficiently. These are the drivers of economic growth, and thus of higher stock prices. When you own a globally diversified portfolio of stock index funds you're investing in human ingenuity and our collective ability to solve problems. John Bogle said: *"Stay the course. No matter what happens, stick to your program. I've said 'Stay the course' a thousand times, and I meant it every time. It is the most important single piece of investment wisdom I can give to you."* Remain optimistic. Don't panic. Keep saving and investing for the long-term.

In the News

Some people are happy during bear markets because it gives them the opportunity to buy stocks at lower prices. Other people, the demented ones, are happy during bear markets because their doom-and-gloom predictions have finally come true. These people are called "perma-bears" because they turn every headline into an end-of-the-world prediction. For some unknown reason, perma-bears are considered to be shrewd and insightful, despite their long history of failed predictions that the end is near. There's one question that the perma-bears cannot answer – why isn't their fear reflected in current market prices? Listening to these people is dangerous because when the world doesn't end, and the market rebounds, they will leave you standing on the sidelines with your hat in your hand. Never forget the one common characteristic of all bear markets: they end.

Two types of people are happy about today's high inflation. The first are those who have debt at low interest rates. High inflation erodes the "real" level of debt and low interest rates make debt easier to service. Inflation wreaks havoc on the economy because it transfers wealth from lenders to borrowers. The other people happy about 8% inflation are the gold bugs. Thanks to social media and YouTube videos, they have never had a wider audience. They claim that gold is a bulwark against inflation. But if that is true, then something is amiss. Gold dropped 4% in 2021 and another 11% this year through the end of October. What's going on? Unlike stocks, bonds, or real estate, gold doesn't produce dividends, interest, or any other kind of income. In other words, it has no intrinsic value. Its price is what the next person is willing to pay for it. Thus, all predictions of its future price are mere speculations. On the Tonight show many years ago, Johnny Carson introduced the notoriously bad Mighty Carson Art Players with the disclaimer – "Buy the premise, buy the bit". But a correct premise doesn't guarantee a correct conclusion. For example, a correct premise – government spending is reckless and out of control. The wrong conclusion – buy gold because the dollar will become worthless and no longer be the globe's reserve currency. For your own sake and peace of mind, ignore the gold bugs and their advertisements. Responsible adults act rationally, and I don't see how hoarding gold makes any sense.

Continuing a trend of the past several years, investors in mutual funds and exchange traded funds (ETFs) continue to favor index funds over actively managed funds. According to Morningstar, index mutual funds and ETFs reported net inflows totaling $665 billion for the 12-month period ended September 30, 2022. Active funds reported estimated net outflows totaling $615 billion. The dollars invested in mutual funds and ETFs is now about evenly split between active and index funds.

The rising popularity of index funds has turned the active world upside down by making it easy for investors to identify low-skill managers - those who continually underperform their index fund competitors. Low-skilled managers get fired, and the most skilled managers survive. For the surviving managers, the competition becomes stiffer, and outperforming becomes more difficult. The rising popularity of index funds has led to a large reduction in the ownership of individual stocks by retail investors. The exit of the "dumb money" makes life even more difficult for active managers since the person on the opposite side of the trade is likely another skilled professional investor. Thus, it comes as no surprise that the percentage of outperforming funds has declined over the past 20 years.

Did you know that the Dow Jones Industrial Average rose 14% last month, its biggest monthly gain since 1976? It reached its low point for the year on October 13th (28,661), after the September CPI was released showing no letup in inflation. Then, for no apparent reason, it rebounded 5% by the end of trading that day. It finished the month at

32,732- a 14.2% gain in just over two weeks. Despite the fact that economic fundamentals have yet to improve, the S&P 500 was up 8.0% in October and the small-cap Russell 2000 index rose 10.9%, according to Bloomberg. Once again, we saw a big upturn in stocks when market timers were still warming up in the bullpen. The perma-bears will call this a temporary "dead cat bounce" that is typical in bear markets. Time will tell, but you will never receive the long-term return of stocks if you only invest in short-term spurts.

When the S&P 500 is Down 25% or Worse Since 1950

Peak	Trough	% Decline	+1 Year	+3 Years	+5 Years	+10 Years
12/12/1961	6/26/1962	-28.0%	31.2%	69.2%	94.8%	171.1%
11/29/1968	5/26/1970	-36.1%	32.2%	44.3%	27.9%	97.5%
1/11/1973	10/3/1974	-48.2%	1.4%	23.8%	42.0%	188.4%
11/28/1980	8/12/1982	-27.1%	43.9%	81.2%	238.6%	403.9%
8/25/1987	12/4/1987	-33.5%	14.7%	34.1%	96.8%	387.1%
3/24/2000	10/9/2002	-49.1%	0.2%	1.9%	21.5%	38.3%
10/9/2007	3/9/2009	-56.8%	-6.9%	3.7%	61.2%	209.6%
2/19/2020	3/23/2020	-33.9%	56.4%	???	???	???
1/3/2022	9/30/2022	-25.2%	???	???	???	???
Averages		**-37.6%**	**21.6%**	**36.9%**	**83.3%**	**213.7%**

Data: Ycharts

How can you be an optimist when things seem so bad right now? These charts from Ben Carlson's blog reveal why. The expected future return of stocks is higher after a significant decline than after a significant rise. In other words, bear markets create higher expected future returns – a classic case of reversion to the mean. As this chart shows, bear markets since 1950 have presented great buying opportunities. Until we get back to green stock returns, it's best to remain optimistic and rely on the lesson of history – the optimists win.

From 2009 through 2021, the S&P 500 yielded an annualized average return of 16% with only one very small down year (2018). This was a 13-year, 60% premium on the long-term annualized average return of the S&P 500. If we go back to the year 2000 and include the dotcom crash, we still have an annualized 9.1% return. But stock market averages hide the unpleasant details. This chart shows the depths and duration of 10 significant declines in the S&P 500 since 2000. Six declines between 10% and 20% and two times when stocks temporarily lost half their value. Despite the volatile ride since 2000, investors with the fortitude to stay calm and focus on the long-term received very acceptable returns. If your investment time horizon is longer than the life of the current bear market, your portfolio will recover – if you can avoid headline driven portfolio tinkering.

Peak	Trough	% Decline	# of Days
3/24/2000	10/9/2002	-49.1%	929
11/27/2002	3/11/2003	-14.7%	104
10/9/2007	3/9/2009	-56.8%	517
4/23/2010	7/2/2010	-16.0%	70
4/29/2011	10/3/2011	-19.4%	157
11/3/2015	2/11/2016	-13.3%	100
1/26/2018	2/8/2018	-10.2%	13
9/20/2018	12/24/2018	-19.8%	95
2/19/2020	3/23/2020	-33.9%	33
1/3/2022	9/30/2022	-25.2%	270
Averages		**-25.8%**	**229**

Data: Bloomberg

From the Every Cloud Has A Silver Lining department - this year's high inflation has led to large inflation adjustments to Social Security benefits, tax brackets and retirement accounts for 2023. Some highlights -

- Social Security benefits will rise by 8.7%. The standard Part B premium (not counting any Income-Related Monthly Adjustment Amount [IRMAA]) will decrease by $5.20 (3.1%) to $164.90.
- The annual contribution limit for 401(k)s, 403(b)s, most 457 plans, and Thrift Savings Plan increases to $22,500, up from $20,500 in 2022. The catch-up contribution amount for those age 50 and older increases by $1,000 to 7,500. In total, employees above the age of 50 can contribute up to $30,000 to these defined contribution plans.
- Annual contribution limits will increase to $6,500 for traditional IRAs and Roth IRAs. The catch-up contribution remains $1,000.
- In 2023, the income phase-out range for Roth contributions for single filers will be $138,000 to $153,000. For married couples filing jointly, it will be $218,000 to $228,000.
- The standard deduction for 2023 increases by $900 for single taxpayers (to $13,850) and by $1,800 for married couples filing jointly (to $27,700), and by $1,400 (to $20,800) for heads of households.
- The annual exclusion for gifts increases to $17,000 for calendar year 2023, up from $16,000 for 2022.