

2018: Volatility Returned with a Vengeance

But it's utterly meaningless to the long-term investor

Conditions across the world's stock markets became more volatile in 2018 following several years of relative stability. In fact, the S&P 500 experienced a second "correction" (defined as a 10% decline from a peak close) in the same calendar year. The only other years this happened were in 1946 and 1947.

Investors had and have lots to worry about including tariffs and trade wars, the outlook for global growth, central bank policies and political risks. In this uncertain environment, it's easy to lose confidence and react to the latest news. Don't fall into this behavioral trap.

Our inaugural newsletter in Q1 2016 made the case for adopting a long-term investment horizon by

providing a four-decade perspective in the form of narrative, data and charts. To reinforce the critical importance of re-wiring one's brain to think of investments in terms of **decades**—not days, we revisit this original perspective at the beginning of each year. The data and charts have been updated with 2018 year-end values.

The major lesson to be drawn from these data is that—historically, at least—temporary stock market declines have been very different from permanent loss of capital, and that the most effective antidote to volatility has simply been the passage of time.

[The article below, along with the data and charts that follow, was originally published in our Q1 2016 Newsletter. The charts have been updated to include 2018 year-end data.]

Perspective from the Past Four Decades: 1975-2015

It's hard to read a newspaper or watch the news and not be depressed. Bad news seems to be the order of the day, every day. Throw in the financial media's tendency to magnify every normal wiggle of the market to grandiose proportions, along with the uncertainty associated with any upcoming presidential election (especially this one), and it would be inhuman not to be worried about staying invested in common stocks during such turbulent times.

The 41 years 1975 through 2015 cover the great bulk of the investing lifetimes of most of today's investors. Moreover, since many of these people's perspective reaches only back to this morning's headlines, they typically have not the faintest notion of what has gone on in America's economy and capital markets between 1975 and today.

If they did, they probably wouldn't be worried. In this inaugural Keating Wealth Management newsletter, therefore, we thought we might take a look at some arbitrarily selected population, GDP, earnings and dividend statistics for five observation points during this period, namely the years ending in 5. Along the way, for additional perspective, we'll look at some events that alternately befell and uplifted us in each of these landmark years.



You can't build a rational long-term plan without access to long-term historical perspective about returns, volatility, and how they are connected. As humans, we are wired in such a way that it is exceedingly difficult to make the right decisions for the long term. We provide that long-term perspective on an ongoing basis, particularly when it's needed most, such as in bear markets.

1975



Saigon falls; President Ford escapes two assassination attempts within 17 days. Margaret Thatcher becomes the first woman leader of Britain's Conservative Party. Andrei Sakharov, the great hero of Soviet resistance, wins the Nobel Peace Prize. Saturday Night Live debuts. An American and a Soviet spacecraft link up in space; the event is memorialized on a beautiful 10-cent U.S. postage stamp.

- ◆ S&P 500 year-end close: 90.19
- ◆ S&P 500 earnings: \$7.71
- ◆ S&P 500 dividend: \$3.73
- ◆ Global population: 4.1 billion
- ◆ U.S. population: 216 million
- ◆ U.S. real GDP: \$5.8 trillion

1985



Gorbachev comes to power in the Soviet Union, and meets with President Reagan. The Internet domain name system is created. Windows 1.0 is published, and the first successful human heart transplant takes place. The song of the year is "We Are the World." In the greatest marketing catastrophe since the Edsel, the Coca-Cola Company introduces New Coke. A first class U.S. postage stamp costs 22 cents.

- ◆ S&P 500: 211.28
- ◆ Earnings: \$15.68
- ◆ Dividend: \$8.20
- ◆ Global population: 4.9 billion
- ◆ U.S. population: 238 million
- ◆ U.S. real GDP: \$8.1 trillion

1995



The Oklahoma City bombing is the greatest domestic terrorist atrocity in American history. O.J. Simpson's murder trial begins, and ends 10 months later in his acquittal. Israeli Prime Minister Yitzhak Rabin is assassinated. The Rock and Roll Hall of Fame and Museum opens in Cleveland. Jerry Garcia dies. A postage stamp costs 32 cents.

- ◆ S&P 500: 615.93
- ◆ Earnings: \$37.70
- ◆ Dividend: \$14.17
- ◆ Global population: 5.7 billion
- ◆ U.S. population: 266 million
- ◆ U.S. real GDP: \$10.7 trillion

2005



Hurricane Katrina devastates an American land mass larger than Great Britain. Saddam Hussein goes on trial for his life. July 7 becomes London's 9/11, as coordinated attacks on the bus and subway system claim 52 lives. Pope John Paul II dies; he will be canonized only nine years later. A postage stamp costs 37 cents.

- ◆ S&P 500: 1,248.29
- ◆ Earnings: \$76.45
- ◆ Dividend: \$22.38
- ◆ Global population: 6.5 billion
- ◆ U.S. population: 296 million
- ◆ U.S. real GDP: \$15.8 trillion

2015/18



[Original 2015 narrative, not updated for 2018 events.] A radical Islamic faction, ISIS, casts the Middle East into chaos, and carries out terrorist atrocities in Paris and elsewhere. Refugees pour into Europe. The world's leading nations reach an accord with Iran on its nuclear development program. Yogi Berra dies. A postage stamp costs 49 cents.

	2015	2018 ¹		2015	2018
◆ S&P 500:	2,043.94	2506.85	◆ Global population:	7.3	7.7 billion
◆ Earnings:	\$117.97	\$162.1	◆ U.S. population:	322	328 million
◆ Dividend:	\$43.43	\$52.3	◆ U.S. real GDP ²	\$17.5	\$18.7 trillion

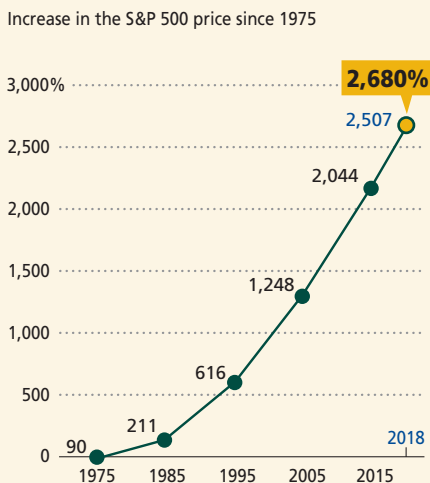
¹ Except for the S&P 500 (which is the Dec. 31, 2018 closing price), all other 2018 values are estimates.

² Billions of chained 2012 dollars. The original 2018 Newsletter used chained 2009 dollars for 1975 - 2015 values and have subsequently been updated.



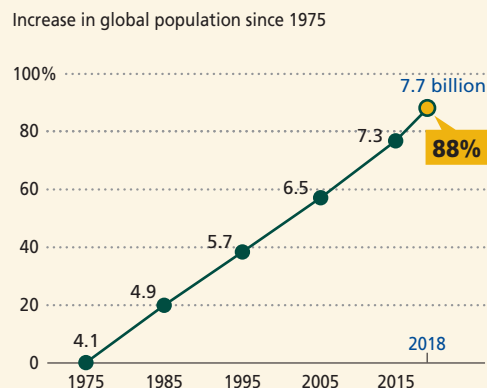
S&P 500 Price

Excluding dividends, the S&P 500 price has increased 28x since 1975, or at a compounded growth rate of 8%



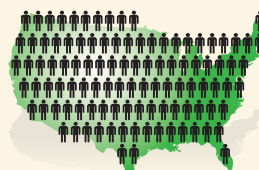
Global Population

Up 88%, but number living in extreme poverty reduced from 1 person in 2 to 1 person in 10



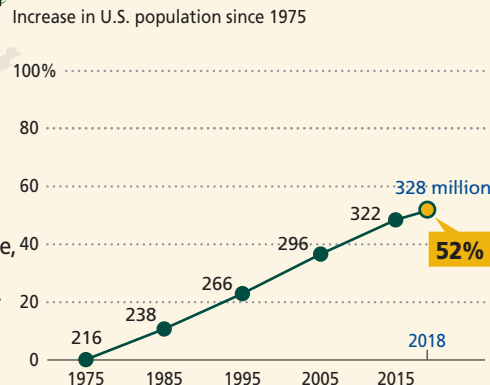
S&P 500 Earnings

Earnings have increased by 21x, or at a compounded growth rate of just over 7%



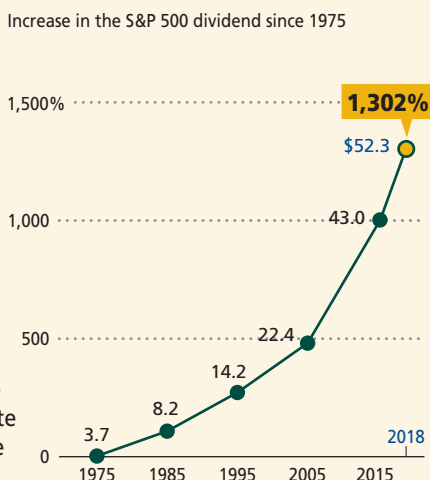
U.S. Population

Now 328 million people, the population has increased by half over this time period



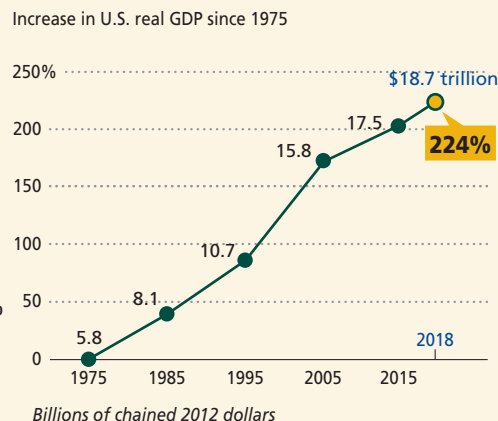
S&P 500 Dividend

Dividends have increased 14x, or at a compounded growth rate of just above 6%—about double the rate of inflation over the same time period



U.S. Real GDP

Real GDP more than tripled, on only a 52% population increase—meaning real GDP per capita has soared



This, then, is the tale of the last 44 years (1975 - 2018):

- ◆ Global population up 88%, with extreme poverty slashed from one human in two to one in 10, creating wave upon wave of new middle class consumers.
- ◆ U.S. population up by half, and gaining a new person (through net births and migration) every 14 seconds. And still almost unimaginable room to grow: population density per square mile in this country is 85, compared with almost 300 in France, 590 in Germany, 680 in the UK...and 870 in Japan. Staggering natural resources, with mineral rights vested in the landowner. A hundred years' worth of hydrocarbon energy reserves.
- ◆ Real GDP more than tripled, on only a 52% population increase—meaning real GDP per capita has soared.
- ◆ The S&P 500 rose nearly 28x, on an earnings increase in excess of 21x and a dividend boost of 14x. Far more significantly, these gains must be measured against an increase in the general level of consumer prices scarcely more than 4.5x. Surely this is the greatest accretion of real wealth by the greatest number of people in the history of the world.

What are the megatrends underpinning this spectacular economic and financial progress? Well, there are two, and of course they form a virtuous cycle. They are the spread of the free market, as liberty vanquished communism and most extreme iterations of socialism during this period, and exponential progress in information technology. (Today, a middle school child carries in his backpack a smartphone with more computing power than the state-of-the-art mainframe had in 1975.) This cycle continues apace.

Source: All population, GDP, S&P 500 price, earnings and dividend statistics through 2015 are sourced from the December 2015 edition of *Nick Murray Interactive*. Permission to use the data and the associated commentary from Mr. Murray's article granted by the author to subscribers of his newsletter. The underlying sources for Mr. Murray's 2015 data have been used to update and provide continuity for the 2018 statistics.

“The Market is Going to Fluctuate”

According to Wall Street lore, an alert young man who by happenstance once found himself in the presence of the legendary J.P. Morgan tried to seize the moment by seeking Mr. Morgan's opinion as to the future course of the stock market. The alleged reply has become classic: “Young man, I believe the market is going to fluctuate.”

It did, it always has, and it always will.

So during periods of market volatility, what should an investor do? The answer: Keep market volatility in perspective, focus on longer time horizons, and maintain portfolio discipline. That's it. In practice, this is exceedingly difficult to do, and that's where Keating Wealth Management can help.

