BUCKINGHAM STRATEGIC WEALTH

Annual Portfolio Performance: A Valuable Metric?

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I'm going to start by providing some basic facts (not opinions, facts). Then, I'm going to ask you a few questions, and I'm hoping you'll write down your best guesses as to the answers. C'mon, it'll be fun!

The facts:

You may have heard that the stock market has returned about 10% annualized for the last 100 years or so. This is very close to accurate, although it's not quite 100 years, as the analytical pundits don't really feel great about data prior to 1926.

What we can say with certainty is that over the period from 1926 through 2018 (92 years), the stock market – as defined by the S&P 500 Index – returned *exactly* 10% per year.

Now, of course, some individual years were more than 10% and some individual years were less than 10%, but taking into account all the highs and all the lows, the S&P 500 has had an annualized return of 10.0% per year over the past 92 of them.

The question:

Of the last 92 years, how many times do you think the stock market actually returned "the average" of 10%?

Stupid question, right? It's really hard to land on exactly 10%. Answer has to be zero. (And it is.) Ok, so how about a range of between 8%-10%? That feels like a fairly decent sized net. And, each year, it seems like every financial "pundit" with a pulpit predicts an 8%-10% return on the S&P 500. In all, that range feels pretty good.

New question:

From 1926 through 2018, 92 years, how many times did the S&P 500 end a year within the range of 8%-10%?

Take your time to think about your answer. Write it down on a piece of paper.

Next question:

Over those same 92 years, how many times do you think the stock market returned greater than 20% (like in 1997, when it returned 38%) or less than negative 20% (like in 1931, when it returned -61.1%)?

Again, take some time to think about it. Write down this answer as well. You can use the same sheet of paper, or just keep the numbers in your head.

Drum roll….

The answer to the first question is *zero*.

That's right, the S&P 500 has never once returned between 8%-10% in a calendar year. I know, it's completely ridiculous. I had to check and double check this result multiple times. It came real close in 1993, when it returned 10.1%, and oddly enough the next closest was the year earlier, 1992, when it returned 7.6%.

Every year, "experts" predict the market will go up between 8%-10% because 1) market predictors talk a ton but say nothing, and 2) they think it's a safe guess. In reality, they're predicting that something which has never happened will occur (again, proving what we know).

The answer to the second question is … wait for it … hold … HOLD … HOOLLLDDD ….

Forty-one times! Wait, what?!? Forty-one times?!? Yes, 41 times in the last 92 years, the S&P 500 returned either greater than 20% or worse than negative 20%. Absolutely nutty.

Nobody digs up a tree by the roots every year to see how it's doing. They wouldn't learn a whole lot (if anything), and they might harm the tree. Yet, investors dig deep into their portfolios' annual returns, not realizing that they aren't learning a whole lot (if anything), and, by doing so, they may actually harm their wealth.

Setting annual goals can make sense in many circumstances. Setting an annual savings goal either as an absolute target or a percentage of income – and then tracking it – is wise. Setting a "fun" goal, whether it be dedicated vacation or more engaged time with those you love, is very wise. Health goals – and tracking said goals – surely are wise as well.

But, even knowing the preceding data, the next few sentences are tough for many to accept.

Setting an annual performance goal for your portfolio is not only useless, but it can be dangerous. It's useless because annual performance is as random as a single spin of the roulette wheel. It's dangerous because it inevitably encourages folks to react.

The moral of the story: Stop looking at annual performance as some sort of goal, or as some sort of marker for success (or failure), or as some sort of controllable outcome, because it is none of those. Try to start thinking in decades when it comes to investment performance. Or, stop thinking about performance at all. Instead, focus on the things you can control, for example, living in alignment with the values you hold dear.

Trust that you have an excellent plan in place to accomplish the things most important to you. But, also know that a good financial plan is not static, but an ever-changing landscape. And, whether the winds of change blow in your favor (inheritance, promotion, marriage, etc.) or against you (disability, job loss, divorce, etc.), a good financial planner and wealth advisor helps you adjust your course while keeping your destination in sight.

This is the big stuff. And it has nothing to do with the variability of Mr. Market.

Returns data is from Dimensional's 2019 Matrix book. Past performance is not a guarantee of future results. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio nor do indices represent results of actual trading. Information from sources deemed reliable, but its accuracy cannot be guaranteed.