

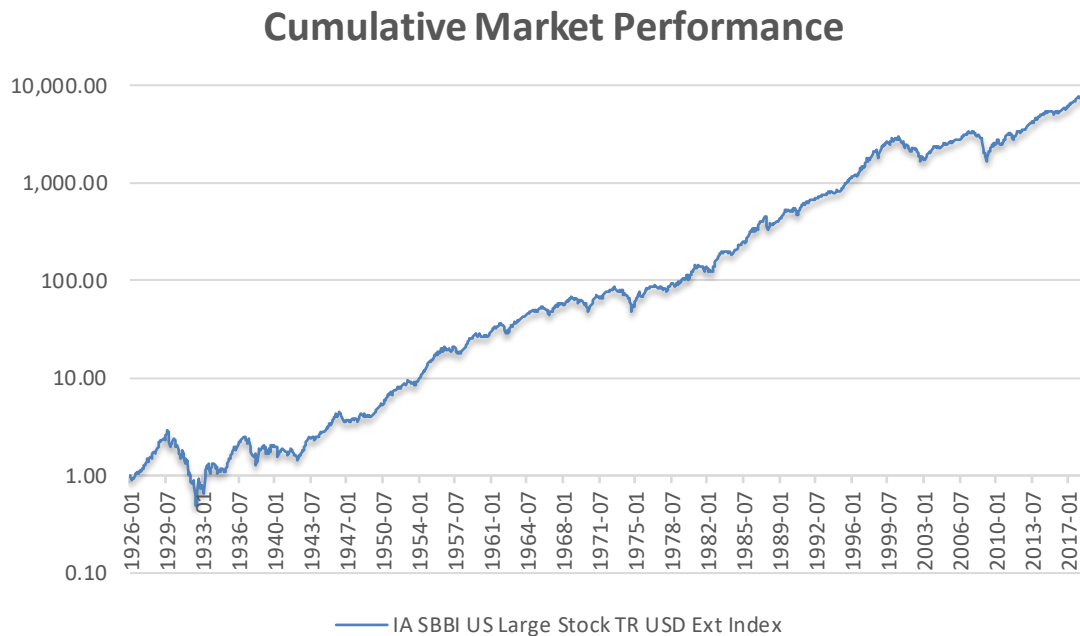
How Common Are New Market Highs?

With the U.S. stock market hitting all time highs, a question you may be asking yourself is, how should I be feeling about that? Phrased another way, how common are market highs? Are they extremely rare and should I be panicking or are they pretty much par for the course?

To try and answer these questions we must put market highs into historical context.

The Eye Test

The chart below illustrates the growth of \$1 invested in U.S. large cap stocks on January 1, 1926. At the end of September 2018, after factoring in the reinvestment of dividends, \$1 was worth \$8,129!



Data Source: Morningstar. Based on month-end values with dividend reinvestment.

Looking at this chart, you would think that the markets are hitting new highsⁱ pretty much all the time! Unfortunately, this chart obscures a less rosy reality.

The Stats

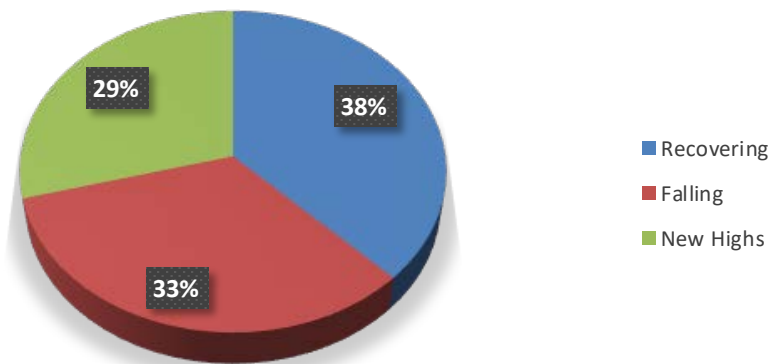
Over the almost 93-year history set out in the chart, U.S. large cap stocks experienced 119 periods where a drawdown occurred (i.e. where the value fell below its prior peak as measured at month-end). And although the average drawdown was -6.8%, there were eight time periods where the decline was greater than -20%. As you would expect,

the largest of all the declines was the 83% plummet in the Great Depression followed by the 51% drop during the 2008-09 Financial Crisis.

The average time from peak to trough was just three months, although this ranged from as little as a month to the 34-month decline during the Great Depression. Recoveries took longer, five months on average. Generally, the deeper the decline, the longer the recovery. Where the decline was in excess of -20%, it took an average of three and half years to recover.

As a result, the average U.S. stock market investor spends the vast majority of their investing life with the value of their portfolio below prior highs. 71% of the time in fact. As illustrated in the following chart, since 1926 investors in U.S. large cap stocks spent 33% of the time watching the value of their stock portfolio fall, 38% of the time watching it recover and 29% of the time watching it hit new highs.

Percent of Time



Source: Tacita Capital Analysis with Morningstar data. Based on month-end values with dividend reinvestment.

That was probably not what you were expecting after looking at the chart on the first page. But what this does tell us is that market highs do occur with some relative frequency and are not complete unicorns. Nor are they the natural steady state. New highs are one of three normal and surprisingly balanced parts of the market cycle.

What about a more balanced portfolio, you might ask? Most people do not invest 100% of their portfolio in stocks anyway. Certainly a more balanced mix will lead to better results. Unfortunately, this is true only to a degree.

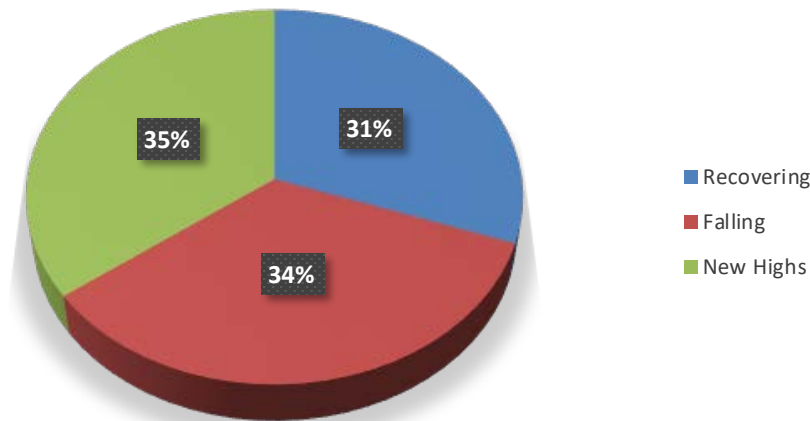
A Balanced Mix

A balanced investor with a portfolio comprised of 35% intermediate-term U.S. government bonds and 65% large-cap U.S. stocks, that rebalanced quarterly, endured 135 periods of drawdown. That is nearly 13% more than the “stock only” investor! Surely a more balanced portfolio must have experienced shorter drawdowns? Well, the average decline period was the same as the stock market, three months.

Where a balanced investor has historically won is their average decline was less than the stock market: -4.3% vs. -6.8% for the “stock-only” investor. Of course, a balanced investor wins big during more severe stock market corrections. Some other good news is that the average recovery period was shorter by a month.

Based on month end data there was some improvement in the amount of time a balanced portfolio was “under water”, but not as much as you might hope. As illustrated on the following page, balanced investors spent 34% of the time watching their portfolios fall in value, 31% watching them recover and 35% enjoying new highs. So, balanced investors spent 65% of their time below prior highs vs. 71% for “stock-only” investors.

Percent of Time



Source: Tacita Capital. Based on month-end values with dividend and interest reinvestment.

An improvement to be sure, but probably not as big as you were hoping for.

So, what did we learn?

New market highs are not uncommon and are in fact part of a normal market cycle of drawdowns, recoveries and new highs. Any portfolio decisions or performance reviews need to recognize this to avoid knee jerk decision making.

However, investors need to be aware that when measured against the previous high, their portfolio will be spending most of the time below it and fighting to get back to it. Understanding this inevitability (and looking at your portfolio versus prior lows as well as prior highs) hopefully makes it a little easier to bear and helps you make it through to enjoy the next market high, before the cycle begins all over again.

28th September 2018
www.tacitacapital.com

Disclaimer

Tacita Capital Inc. (Tacita) is a private, independent family office and investment counselling firm that specializes in providing integrated wealth advisory and portfolio management services.

Tacita research has been prepared without regard to the financial circumstances and objectives of any individual investor. The asset classes/securities/instruments/strategies discussed may not be suitable for all investors and certain investors may not be eligible to purchase or participate in some or all of them. Whether a particular investment or strategy is appropriate depends on individual circumstances and objectives. Investors should therefore independently evaluate particular investments and strategies or seek the advice of a financial advisor.

All investments involve risk including loss of principal. Past performance is not necessarily a guide to future performance; estimates of future performance are based on assumptions that may not be realized. Management fees and expenses are associated with investing.

Tacita research is based on public information and is prepared for informational purposes. While we make every effort to use reliable, comprehensive information, we do not warrant that it is accurate or complete. We assume no obligation to inform anyone should the opinions, estimates or information provided change.

Tacita research is not intended to provide tax, legal, or accounting advice. Investors should obtain their own professional advice in this regard.

Neither the information provided nor any opinion expressed in our research constitutes a solicitation by Tacita for the purchase or sale of any securities or financial products.

ⁱ For purposes of this article, we define highs to include reinvestment of dividends and interest.