Client's Corner

The Siren Song of "The Market's Too High"

AS I WRITE, IN MID-DECEMBER, THE S&P 500 HAS COMPOUNDED at about 17.5% annually in the twelve and three quarter years since the Global Financial Crisis bottomed out in March 2009.

And that's nothing. Since the trough of last year's Corona Crash in March 2020, it's been compounding at an annual rate of more than 40%.

Even considering that these returns are measured from two very significant panic bottoms—down 57% and 34%, respectively—those are torrid percentages when compared to the S&P 500's long-term average of just over 10% annually.

And so one begins to hear on the wind—faintly, but growing in volume—one of those classic Sirens' songs that have lured generations of investors to destruction: "The market's too high." (On alternate days, the Sirens sing, "Let's get out and wait for the correction." The message is essentially the same, as is the Sirens' malign intent.)

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The purpose of this little essay is to suggest that our emotional reaction to the level and trajectory of equity prices is very much affected by the start date we use to measure returns. To illustrate this hypothesis, I would suggest we look at returns since another highly resonant date: March 24, 2000.

And what specifically (you ask) is the significance of that date? I will happily tell you.

March 24, 2000 was The Day the Bubble Popped. It was the tippy, tippy top of the greatest bull market of all time, which had started in August 1982; its terminal phase was the infamous Dot. Com Bubble, a mania for the ages. The S&P 500 closed that fateful Friday afternoon at 1,527.50.

There followed not one but two significant bear markets, the former attendant upon the implosion of dot.com and the latter the aforementioned Global Financial Crisis. As noted, the equity market has, with a few interruptions, been rising pretty smartly ever since. Cue the Sirens.

And what—nearly 22 years after that epic market top—has the S&P 500 returned on an average annual compound basis? The answer, I'm intrigued to discover, is 7.5%. Yes, that's right: even today, mainstream equities' average annual compound rate of total return for two decades plus remains quite significantly below their long-term 10% trendline. Could it be that—far from being "too high" in any long-term sense—the equity market is ***still just playing catch-up?***

I'm sure I don't know the answer to that question. I'm comforted by the fact that no one else does either.

Is this me suggesting that equities can continue to compound at the 17.5% they've done since March 2009—much less the 40% since March 2020? Of course not. My blissfully unscientific guess is that at some perfectly unpredictable point in time—and on some perfectly unpredictable trajectory—returns will most probably start cycling down toward that long-term average 10%. (They'd almost have to.) Note that this opinion and $2.75 will get you a ride anywhere you want to go on the New York City subway system.

What I know for an absolute fact is that I can't time this settling down of returns. Again: neither can anyone else. I can also report that, over a fifty-plus year career in investing, I've watched a whole lot of people take their capital out of equities because they "had come too far too fast," "were too high," and "were overdue for a correction." Sooner than later, in my experience, most came to regret it.

I leave you to ponder the words of the immortal Peter Lynch:

"Far more money has been lost by people preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."

Amen. Happy New Year.