Client's Corner

How to Respond to a Crisis: Don't.

TELL ME IF ANY OF THE FOLLOWING COLLOQUIES SOUND familiar to you—so familiar, perhaps, that you might even remember taking part in one or more of them:

Investor: "We have to get out of the stock market. A hundred-year global health crisis is upon us, and the world economy is shutting down. The market is already down by a third in just four weeks, with no end in sight."

Advisor: "It seems probable that most of the market damage has already been done, if not overdone. This looks like a pretty predictable panic response to the tremendous shock of the pandemic. I imagine there'll have to be massive fiscal and monetary response in support of the economy. We've got a very good long-term plan, and your best bet would be to stick with it. Indeed, panic times are usually good opportunities to add to our quality holdings."

That conversation would have taken place a little over two years ago, in the latter part of March 2020. Here's one that would have been slightly more recent:

Investor: "This upcoming presidential election is unlike any other in our lifetime. If [fill in the blank] gets elected/reelected, it will be the beginning of the end of American democracy, and the stock market will surely crash. We simply must get out."

Advisor: "I think that's probably what a lot of people thought and said around most of the elections since Adams vs. Jefferson in 1800. American democracy is a pretty hardy species—indeed it's by far the longest-lived and most successful democracy in history. Even more to the point, good companies—such as those in the portfolios we own—have shown a terrific ability to triumph over all kinds of geopolitical crisis. We've got a really well-thought-out retirement plan going for you; best to just keep working it."

You'd have heard that one, in its several iterations, from the early fall of 2020 right on through January 6, 2021.

Now here's one you might have heard (or even participated in) as recently as yesterday afternoon:

Investor: "We simply must get out of the stock market. Inflation is raging at historic levels. The Fed is going to have to strangle the economy in order to wring inflation out of it. Interest rates must soar, the economy must fall into recession, and the stock market must crash. It's as plain as the nose on your face."

Advisor: "You're probably right that the economy is going to have to swallow some pretty bad-tasting medicine to kill this inflation bug. Problem is that you can't predict a recession's peak and trough—and even if you could, you can't time the equity market's response—***if any.*** So you not only have to get out right, you then have to get back in expeditiously. I sure don't know how to do that, and I love our long-term plan. Best to just ride it out, whatever 'it' is. Last time this happened, once inflation was well and truly dead with a stake through its heart in the summer of 1982, the market went up something like 14 times in the next 18 years. Sure wouldn't want to miss out on anything remotely like that."

I'm guessing that by now you see the pattern here. But if not—or just not yet—let me cite a few other data that you may find instructive.

Let's start with the fact that, if you're 50 years old, the Standard & Poor's 500-Stock Index has halved three times in your life. (As you'll see in a moment, even if you're just 25 years old, it's happened twice.) To wit:

January 1973–October 1974	-48%
March 2000–October 2002	-49%
October 2007–March 2009	-57%

Be assured that these declines occurred because of very real crises. In 1973–74 we had the existential constitutional crisis of Watergate and the OPEC oil embargo, in which oil prices tripled overnight. The implosion of the dot-com bubble—the most egregious stock market mania in the history of mankind—set off the second episode. And the third meltdown was in response to a global financial crisis, during which the entire world's credit system essentially ceased to function. Surely you'd have been right to get out of the market in response to one (if not all) of these cataclysms…wouldn't you?

Well, maybe. Then again, maybe not.

The S&P 500's peak in January 1973—just prior to that 48% drop—was 120. The dividend that year was $3.61. As I write, the Index is around 4,400, and the dividend last year was $60.

You didn't ask, but the average annual compound rate of total return of the S&P 500 from January 1973 until last month—***after the Index halved three times in the interim***—was 10.5%. Which is almost exactly what its long-term (1926–2021) average has been. That's not some quirky, abstract market statistic; it's the ultimate testimony to the resilience of the great American companies.

Too much ancient history? Again, maybe. But again, if you're a 50-year old couple, you may have a dozen or more years to work, and upwards of three decades to live in retirement after that. If you have anything close to that kind of investing time horizon, I'd say the foregoing analysis is very relevant indeed. (And I'll bet your financial advisor would agree with me.)

At least historically, the best response a long-term, goal-focused, plan-driven investor can make to crisis is no response at all—or, more accurately, to just tune out the apocalypse du jour and continue acting on your plan. Warren Buffett's teacher, the immortal Benjamin Graham, expressed this most pointedly:

"The best way to measure your investing success is not by whether you're beating the market but by whether you've put in place a financial plan *and a behavioral discipline* that are likely to get you where you need to go *(emphasis added)*."

Amen to that.

Sources: Three bear markets: Standard & Poor's, Yardeni Research. Dividends: "S&P 500 earnings history," NYU Stern School. Compound returns: DQYDJ.com S&P return calculator (underlying data are from the Nobel laureate Dr. Robert Shiller).