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Lessons from 20 years in the stock market

Personal Finance

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I recently had the honor of spending time on the floor of the New York Stock Exchange. I was even given the privilege of banging the gavel on the podium overlooking the floor. Standing there, overlooking that floor where so much of the world's trading goes on, was an amazing experience. I never imagined that such an event would mark the 20-year milestone of my career in financial planning and money management.

Both the stock market and the bond market have performed well during that time. From the beginning of 2003 to the end of 2012, stocks measured by the S&P 500 have averaged 8.2 percent and bonds have averaged 8.6 percent. However, these positive returns have been achieved with high levels of volatility at times.

Depending on the timing of entering the market, one could have experienced losses, either temporarily or over an extended period of time. However, the longer one remained committed to stock investments, the more likely that healthy, positive gains would have been realized when looking at the history of the markets.

I entered the business in 1993. A year later, in 1994, the Federal Reserve hiked interest rates and, according to a recent article in The Wall Street Journal, bond prices were down almost 24 percent that year. This was quite a shock to a lot of bond investors who became accustomed to declining interest rates and increasing bond prices. Many bond investors who were frightened by the declines in 1994 avoided buying new bonds, even though prices were lower and yields higher after that year. This became a good buying opportunity for long-term, fixed-income investors.

Starting in 1995, stocks began a five-year run, showing gains of 20 percent or more each year. At the same time, the shares of many technology companies were performing even better. During this time, many investors sold shares of stocks in underperforming industries to gain heavier exposure to the technology sector.

Chasing after the hot sector proved to be a major mistake. Beginning early in 2000, the markets fell sharply, and from peak to trough, lost more than 45 percent in value, with the technology-heavy Nasdaq losing much more. The so-called tech bubble burst. Investors should have maintained a proper level of diversification and not become overly exposed to one sector.

Highs and lows

Alan Greenspan notably referred to the market's skyrocketing performance leading up to the 2000 downturn as being based on "irrational exuberance." As promising as some of the "dot-com" businesses seemed to be, real earnings were not panning out for many of them.

Lots of positive speculation in the market drove prices higher and higher. Millionaires were created on paper. If they sold shares at exactly the right time, they may have made out very well while others lost large sums of wealth virtually overnight.

As happened with the bond market selloff in 1994, most long-term investors lost money in the markets between 2000 and 2002. Some investors sold at or near the market lows and decided never to risk their money again in the market. The same thing happened in 2008 and early 2009 – the years that became known as the "Great Recession." The markets went through a severe correction similar to the 2000 through 2002 correction, and many investors sold at or near market lows.

The subsequent years were very strong for stocks, with the markets fully recovering their losses in a four-to-five-year period after the market bottomed. Again, these periods of fear were great opportunities to enter the market or add to existing positions.

It's extremely important to step back here and look at long-term investment strategy. It's instructive to look at the last 20 years of market performance, especially for people in their 50s or younger; those in good health who plan to continue working.

When time is on your side, patience and tolerance for short-term volatility are traits that tend to serve you well as an investor. Two-to-three-year periods of market declines can be considered short-term to those who are investing funds for long-term goals, which may be decades away.

Using some very simple math, when I look at my own 20 years in the business, from 1993 to today, the stock market has increased nearly fourfold. Twenty years ago, the Dow Jones Industrial Average was at approximately 3,500, and as of the beginning of April, stands at 14,550. A well-managed stock portfolio during the last 20-year period has proven to be a very lucrative long-term investment.

The luxury of time and the discipline to endure market swings are two of the best friends an investor can have. Historical perspective, patience, insightful analysis and good counsel are some of the enduring principles that wise investors apply to their strategies. NHBR

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