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Voices: Odds Favor an Up Year for Stocks

Advisers should remind clients that stocks deliver positive returns in most years—and often slide 5% to 20% at some point in an up year.

ENLARGE

Long-term investors are better off ignoring market turbulence like that at the start of 2016, this adviser says. *PHOTO: RICHARD DREW/ASSOCIATED PRESS*

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1 COMMENTS

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Poor stock-market returns earlier this year had many people projecting a down year or even an impending recession. Volatility often sparks those fearful predictions. But when you look at the data—in particular, S&P 500 returns over the last four decades—the numbers tell a different story.

What most investors don't realize is that going back to 1980, the S&P 500 (with dividends reinvested) posted positive returns in 30 of those 36 years. That's 83% of the time. This track record occurred despite temporary pullbacks of 5% to 20% during almost every one of those positive years. The six down years were either during a recession, just before a recession (in 2000) or just after one (in 2002).

What I find most surprising about this data isn't only how often the S&P 500 posted positive returns, but that in 20 out of those 30 up years we saw double-digit growth.

So despite that bad start to 2016, it's very likely that we will have an up year when it's all said and done. It might not be the roughly 13.5% return we saw in 2014, but it could well be greater than the 1% return we saw last year. [After a turbulent start, the first quarter saw small gains for the S&P 500 and the Dow Jones Industrial Average.]
In our view, the early-2016 market decline likely wasn't the beginning of a recessionary bear market. When we're trying to determine the possibility of a recession, we look closely at a few factors, one of which is the yield curve. In particular, we focus on the difference between interest rates on long- and short-term debt.

The larger the spread between the interest rate on 10-year Treasurys and very short maturities, the stronger the economic outlook. Why? Because bank lending, and the availability of that money, has a tremendous impact on the health of the economy.

Banks borrow at short-term rates and lend at long-term rates in the form of mortgages, business loans and other loans. Home buying and business expansion are both positive signs for the economy. Currently, the spread between the one-month Treasury rate and the 10-year rate is about 1.6 percentage points, which means that banks are making profitable loans.

But if you look at the periods leading up to past recessions, there was almost always an inversion of the yield curve, with short-term rates higher than long-term rates. At that point, banks stand to lose money on lending and it becomes very difficult for people to get home or business loans.

Right now, a healthy 1.6-point yield-curve spread suggests that the economic outlook remains favorable. Should that yield curve flatten, however, or become inverted, we would need to consider the possibility of a recession in the near future.

The point that we stress to clients is that volatility comes with the territory. Stocks climb a wall of worry, and those who sell during downturns lock in a low price, usually penalizing returns. The best strategy is still to ride out corrections and remain invested during economic expansions.