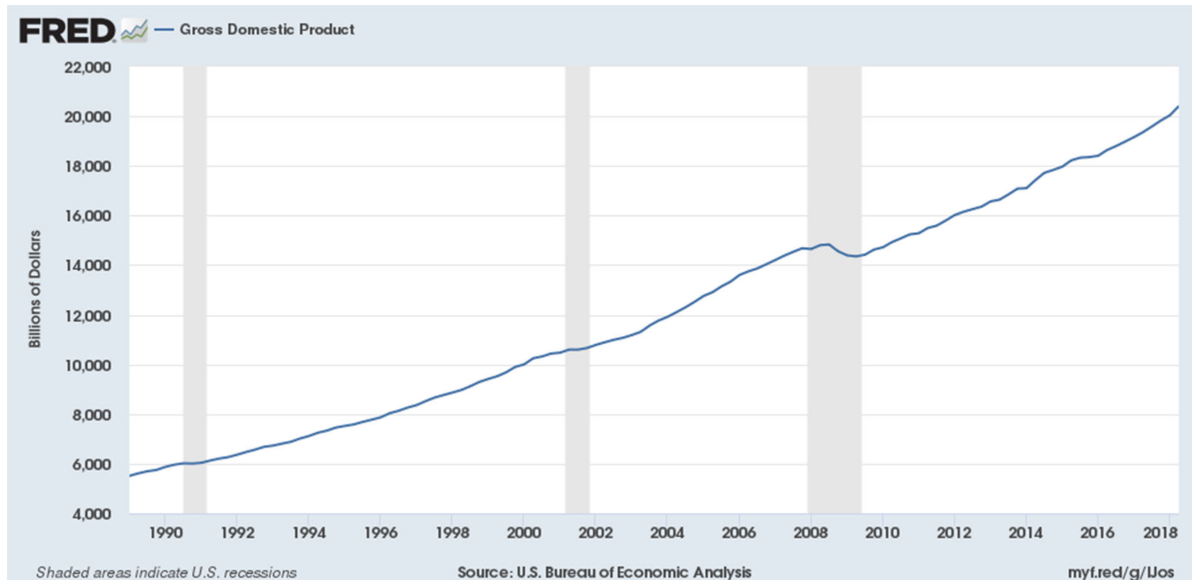
CAUBLE & HARRE
WEALTH MANAGEMENT

12977 NORTH 40 DRIVE, SUITE 213
ST. LOUIS, MO 63141
314-576-1112 | CAUBLEHARRE.COM

Market Note | October 26, 2018

We wanted to add some additional color to the note we sent out October 12.



This looks like a nice line. Why can't a portfolio's returns look like this over time? Wouldn't it be nice to be able to invest in something like this?

This graph shows Gross Domestic Product for the US since 1988. This is our economy. Through all the bad things that people feared would happen and all of the difficult things that actually did happen, our economy has continued to grow. Sure, there have been some periods of decline (especially 2008), but our economy has always rebounded. It shows a history of a lot of people making adjustments and moving forward.

Most people need their savings to grow over time, and they need to earn a rate of return higher that what they can earn in CDs. Note in the graph above that Gross Domestic Product increased from about $5,400 billion in 1988 to $20,600 billion today. GDP grew 3.8 times over this time period.

Can we invest in this? Yes. This is why we invest in stocks. When economies grow, companies can grow their revenues and earnings. When they do this over time, they become more valuable (the value of their stocks goes up).

The really good news is that because of how companies are structured, companies can sustainably grow their earnings at a faster rate than the overall economy. Over this same time period, when the economy grew by 3.8 times, reported earnings per share for the S&P500 grew by about 6 times.

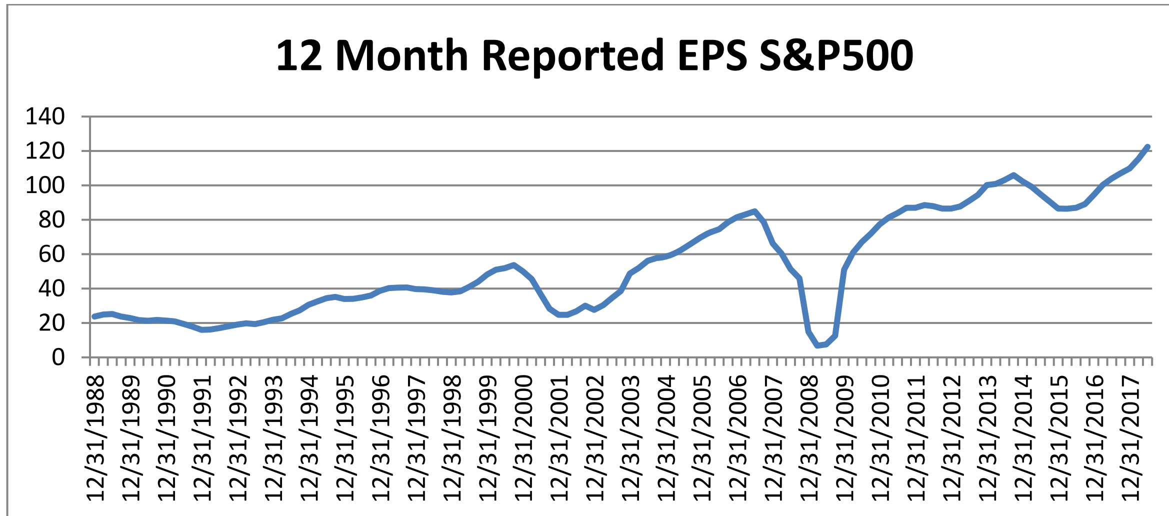
The bad news is that the pattern of growth for corporate earnings is not as smooth, as the next chart shows.

LIZ H. CAUBLE, CFP
liz@caubleharre.com

PETER B. HARRE, CFA
peter@caubleharre.com

CAUBLE & HARRE
WEALTH MANAGEMENT

S&P Dow Jones



There are reasons that this line is not as smooth. I want to keep this note to two pages, so I won't go into them, but there are logical reasons. Furthermore, investors can value this changing stream of earnings differently at any given time, sometimes based on their emotions. The result is that stock prices go up over time because of the first graph, but the pattern is even more chaotic than the second chart.

So how do we benefit without losing our minds? Let's look at a specific, but aggressive diversified portfolio that produced an average annual return of 6% for the last 15 years. That sounds pretty good, and it is a rate that is larger than the growth of the economy. Below is an actual pattern of annual returns from this investment:

-3.6, 14.1%, 20.1%, 5.6%, -0.6%, 7.1%, 18.7%, -3%.

Again, this somewhat aggressive and it declined 36% in 2008. My point is to show the broad pattern of returns that produces an average annual return if you have stocks in your portfolio. The higher return from stocks comes with the challenge of dealing with the return pattern. Of course, having less exposure to stocks would produce a more muted or less variable pattern of returns than shown above, but it would still be a variable pattern. This is what most of our portfolios have.

We believe in the first graph, and the second graph, which is why we include stocks in portfolios, and we include them in moderation. There are more declines and corrections than there are recessions. You cannot avoid all of the declines, but we do stay on the lookout for recessions. On that front, we think we are okay for now.

Regards,

Peter B. Harre, CFA