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Asset Allocation

TIME TO BUST SOME POPULAR INVESTING MYTHS

By Michael Chu, Senior Wealth Advisor

Rules of thumb can be very useful. But sometimes they are wrong – dangerously so. We decided it would be good to share and discuss some of the more popular myths about investing.

Myth #1: To succeed, you must time the market

It's natural for investors to want to invest at stock market lows and then cash out at the highs. Who wouldn't want to avoid the declines and reap the rewards? The problem is, no one can predict when these events will occur. The stock market outlook can be bright – and suddenly a crash occurs. Or, conversely, things can seem really dark but turn out to be the start of a bull market.

We've written much about timing the market; that timing is extremely difficult, if not impossible. Sure, we might be lucky sometimes and get it right. But consider this: The stock market, while volatile year to year, is up almost 75% of the time. So right away, by staying out of the market, the odds are against you. And then you also must decide when to go back in. That's two things you must get right – making timing a lot harder than it seems.

The other aspect to think about is time *in* the market. Even if we had super-bad luck and invested only at market peaks, the results aren't that bad over time long-term. This is because, if we stay invested, market downturns are eventually made up for. The key is just that: *to stay invested*. Over the last 20 years, missing the market's best five days would have reduced your profit by half compared to staying in the market. Missing the best 30 days would have reduced your profit by 80%. Granted, missing the worst days would help stem your losses. But a market timer is more likely to miss out on the good days than the bad.

Over the short term, stocks can be very volatile. But over longer periods, say over 10 years, stocks become much safer. Since 1927, 88% of 10-year rolling periods have been positive. Even three-year periods have been 77% positive. Attempting to avoid the declines will likely give you lower returns over time.

Myth #2: You should wait until the dust settles before investing

The last few years have given us great examples of things not always turning out as expected. In 2020 the economy was terrible, yet the stock market boomed. And then in 2022 (so far), the economy is on fire but the stock market has been very volatile.

The following is a chart of annualized returns of the S&P 500 at different levels of unemployment.

Seems counterintuitive, doesn't it? Investing when things look bleak can lead to amazing returns. And investing when things look wonderful

Unemplyment Rate	Stock Market Returns
Above 9%	24.5%
7% to 9%	15.1%
5% to 7%	8.3%
Below 5%	3.9%

Source: Ben Carlson

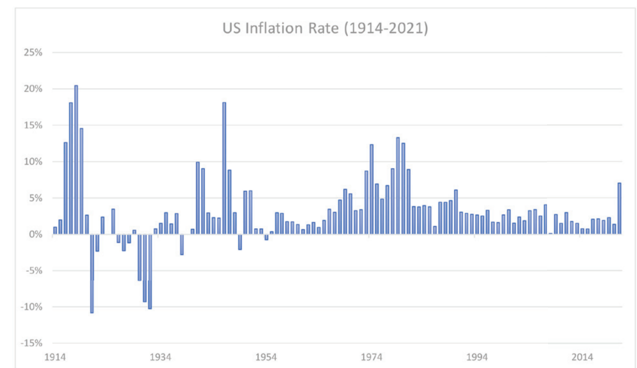
typically leads to lower gains. But it makes sense that returns are better when the economy is bad. Prices are likely lower and there is more room for improvement!

When the economy is firing on all cylinders, stock prices have likely moved higher already. The stock market also does a good job of front-running the economy in anticipation of things changing – that's why we say it's forward-looking. You will typically see the stock market going up or down before the economy improves or slows down.

Myth #3: Just wait for things to return to "normal" to invest

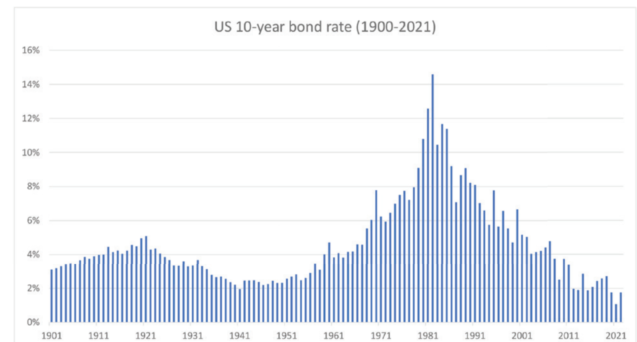
Waiting for things to become more "normal" might be comforting. But what is normal?

This is the inflation rate over the last 100+ years:



Source: Macrotrends

This chart shows the interest rates on 10-year bonds over the past 120 years:



Source: US Federal Reserve, Shiller

What's the normal inflation or interest rate? Hard to say.

Here's a breakdown of various investing stats going back to the 1930s:

Decade	Stock Returns	Bond Returns	Avg. 10 year Yield	Average Inflation	Nominal GDP Growth	Earnings Growth	Avg. Dividend Yield
1930's	-0.9%	4.0%	2.9%	-2.1%	-1.4%	-5.7%	5.5%
1940's	8.5%	2.5%	2.3%	5.6%	11.2%	9.9%	5.7%
1950's	19.5%	0.8%	3.0%	2.0%	6.3%	3.9%	4.9%
1960's	7.7%	2.5%	4.7%	2.3%	6.6%	5.5%	3.2%
1970's	5.9%	5.4%	7.5%	7.1%	9.7%	9.9%	4.0%
1980's	17.3%	12.0%	10.6%	5.5%	8.3%	4.4%	4.2%
1990's	18.1%	7.4%	6.7%	3.0%	5.6%	7.7%	2.4%
2000's	-1.0%	6.3%	4.5%	2.6%	3.9%	0.6%	1.8%
2010's	13.4%	4.1%	2.4%	1.8%	4.0%	10.6%	1.9%

Source: Ben Carlson

Which environment was normal? It seems like there's no such thing as normal with the stock markets or economy. Perhaps the only constant is change.

Myth #4: Higher yield makes a safer investment

We all like collecting dividends. Who doesn't like getting paid quarterly just for holding onto a stock? Higher dividend yields may also be a good indicator of value. But sometimes high dividend yields can be risky. A company can be in distress but doing everything possible to maintain its dividend. So, its dividend looks good but its business is declining. We call this a *value trap*. There are other factors we can look at to help avoid traps; it's important not to focus just on dividends. Total returns, that is, dividends *including* price returns, are what really matter.

Myth #5: New highs mean the stock market is about to crash

We all know the feeling. It seems scary when the market is at all-time highs, because eventually one of these will be the high before the bear market. While this is true, all-time highs occur more than you think.

New highs can be followed by higher highs – it's just a number, after all. Many things, like valuations, earnings, inflation and interest rates, factor into market drops. It's never clear how these interact until after the drops occur – and hindsight is usually too late.

Decade	New Highs
1950's	141
1960's	224
1970's	35
1980's	190
1990's	310
2000's	13
2010's	241
2020's	102

Source: Ben Carlson

Myth #6: The stock market is like a casino

Some people associate investing in stocks with gambling. It's true they are similar in some ways, for example, there are "odds" and "payouts" with both. But at the casino, the more you play, the greater your chance of walking away a loser. This is because the casino has better odds than you. Math dictates you will eventually lose.

With the stock market, it's the opposite. The longer you invest, the greater your odds of success. This is because on a daily basis, it's nearly a coin flip as to whether the stock market is up or down. But over longer periods, say 10 years, your probability of success increases dramatically. As you can see in the chart, with a one-year time horizon your chance of losing is 31%. But at 10 years, your chance of losing decreases to 6% and then eventually to 0% over 20-year periods.

Chance of Negative Return	1 Year	5 Years	10 Years	15 Years	20 Years
Stocks	31%	14%	6%	1%	0%

Source: Siegel, Shiller, CRSP, Cdn Institute of Actuaries, TSX, Bank of Canada

The longer your time horizon in the stock market, the greater your chances of walking away a winner.

Myth #7: Volatility is the same as risk

Some people think *risk* and *volatility* are the same. While it's true that both can make your stomach churn, volatility is different from risk if you look at longer time periods. Volatility is just the ups and downs which, while uncomfortable, eventually cancel out. Risk, on the other hand, is a permanent loss. Permanent losses are the worst because you cannot recover from them, for example, if you suddenly need money and are forced to sell your stocks at a loss.

Risks and volatility appear to be higher for stocks and lower for bonds. If you need your money soon, you should have it mostly invested in bonds to help minimize risks. But in the long term, it's the opposite: Risks and volatility appear to be lower for stocks and higher for bonds. If you don't need your money for a long time, then you can be invested mostly in stocks to maximize returns. This is because stock market downturns are eventually more than made up for by market upturns – you just need time, and to stay invested. The bottom line is that *when* you need your money should determine how you allocate your investments between stocks and bonds.

These are some of the popular investing myths; there are many more. Keep in mind it's okay to use rules, but nothing is absolute. Everything should be backed up with facts – like the rules in our stock strategies. We use a wide range of rules, all make sense and are supported by good, long-term track records.

Michael Chu is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Michael is a specialist in investment research and information technology.

CIBC WOOD GUNDY | The Stan Clark Financial Team
Where planning, investing and behavioral finance meet

Phone: 604 641-4361 | Toll-free: 1 800 661-9442 | Fax: 604 608-5211 | Email: stanclarkfinancialteam@cibc.ca | www.stanclark.ca

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