

“The stock market is a device for transferring money from the impatient to the patient.”

Warren Buffett

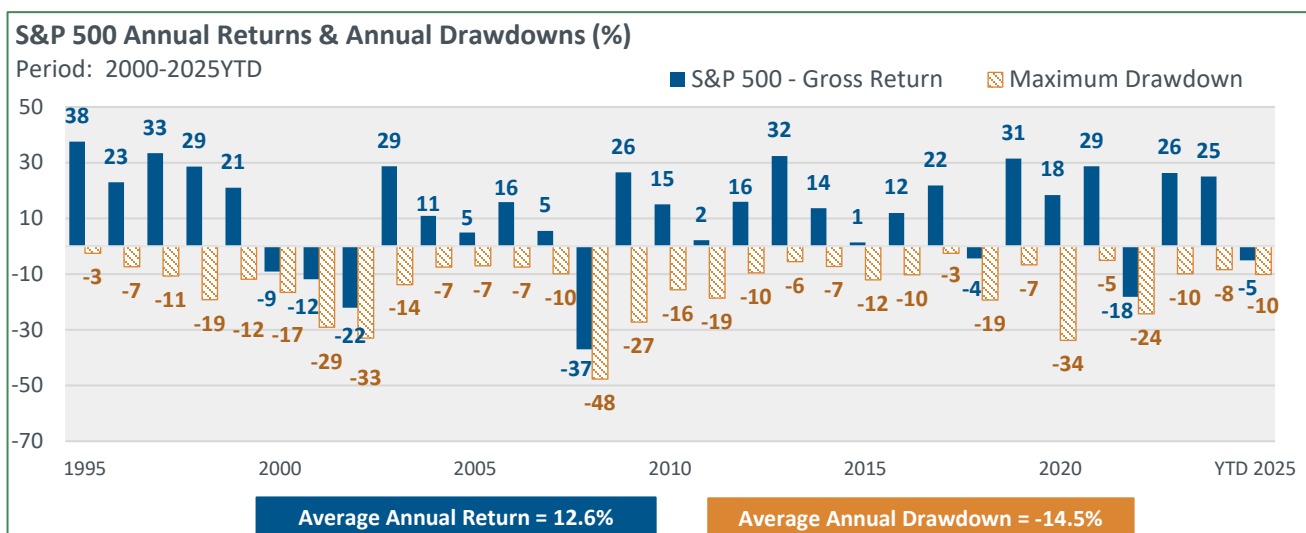
If you find yourself worried, or confused, by the state of the financial markets – you are not alone. The markets have a general dislike of uncertainty, and we have experienced elevated levels in the last few weeks. The S&P 500, after reaching a new high on February 19th three weeks ago, has dropped nearly 10.1%. The primary contributor to this drop is the rapid and confusing stream of news coming from the new administration. The ability to separate rhetoric from reality and to confidently make decisions is, at best, challenging under present conditions.

The purpose of this piece is not to provide clarity on the future path of fiscal policy; there is none at this point. The purpose is to provide historical context for the expected, but unwelcome, corrections that are a regular occurrence in the stock market. Market corrections are more common than most realize - and this periodic volatility is the price we pay for long-term wealth accumulation through equity investing.

CORRECTIONS ARE COMMON

Market corrections, defined as a drop of more than 10%, are a normal part of the life of equity investors. They can be caused by many factors: economic shocks, natural disasters, election results, military conflicts, terrorist events, and yes – an elevated level of uncertainty.

The chart below looks at the annual returns and annual drawdowns (another term for a decline) since 1991. The annual return of the S&P 500 is the blue bar, and the maximum annual drawdown is the orange crosshatched bar. The average annual decline over the past 30 years, from the peak to trough in each year, is -14.5%. This means that equity investors should expect their equity portfolios to experience drawdowns at some point each year, on average. The last two years have featured below-average volatility, with 2023 having a -9.9% drawdown and 2024 a -8.5% drawdown. In comparison the last 3 weeks have delivered a -10.1% decline, less than the average year, but no less disconcerting for investors. Of course, these selloffs can vary widely in magnitude, but it is helpful to remember that despite these events stocks have delivered annual gains in a remarkable 28 out of 33 years.



BEAR MARKETS

A more severe but less common correction, greater than 20%, is the dreaded “bear market.” Bear markets are generally associated with an economic recession, but not always. In 2022, a recession was widely forecast as the Fed increased short-term rates to slow business activity – with the end goal of driving inflation lower. Inflation did come down from 9.2% to 2.8% and we did not have a recession, but we did experience a 9-month bear market.

The chart on the right shows the four bear markets we have experienced since 2000. Not listed is the fourth quarter of 2018 which had a correction of -19.8% lasting 3-months, just shorter than the bear market definition. Perhaps the most important takeaway from this chart is, like corrections, bear markets are a normal part of the equity investing. Taken over longer time horizons, they are but speedbumps in the creation of wealth. Over the last 30 years, a period that includes four bear markets and numerous corrections, the S&P 500 has generated an annualized return of 10.6%, or a cumulative gain of 2,040.6%.



LONG-TERM HORIZON

Market corrections and bear markets occur in the normal course of investing in equities, and we believe it is impossible to time or predict their occurrences. As an equity investor, it is critical to both financial outcomes and mental health to have a longer-term time horizon. Updating a mailing we sent out in 2022 on this very topic, and using data from 1974-2024, the benefits of staying invested are apparent:

Rolling Time Period	Number of Periods	# Positive	# Negative	% Positive	% Negative	Worst Return %	Best Return %	Average Return %
1 year	201	162	39	80.2%	19.8%	-38.8%	60.9%	13.2%
3 years	193	174	19	90.2%	9.8%	-16.1%	32.8%	12.0%
5 years	185	167	18	90.3%	9.7%	-4.8%	28.6%	11.9%
10 years	165	157	8	95.2%	4.8%	-3.0%	19.4%	11.7%
15 years	145	145	0	100%	0.0%	4.0%	19.2%	11.3%
20 years	125	125	0	100%	0.0%	4.8%	18.2%	11.1%

Rolling Quarterly Periods from 1/1/1974 through 12/31/2024
All returns over 1 year are annualized

Source: Factset

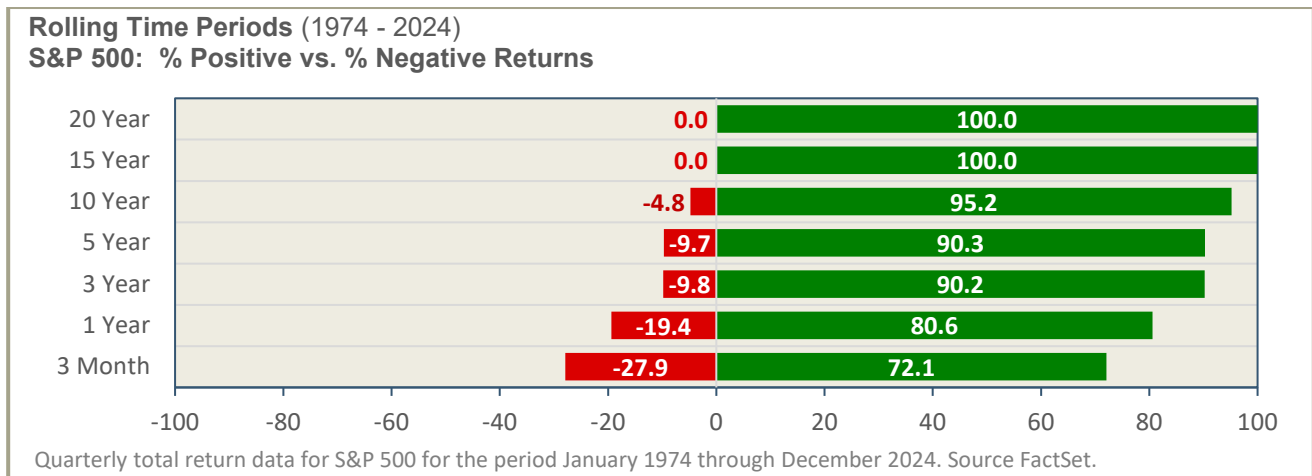
On any given trading day there is a 47% chance the market will be down. For any given month, there is a 37% chance for a negative return, and for any given 3-month (or, quarterly) period, there is a 29% chance. Yet, as the table shows, that percentage drops to 19.8% for one-year periods, 9.7% for 5-year periods, 4.8% for 10-year periods, and 0.0% for periods longer than 15-years. Regardless of the time period the average

annualized returns are between 11.1% and 13.2%. Looking specifically at the 5-year period, staying invested for five years not only increased the likelihood of a positive return to 90.2% of the time, but also dampened the magnitude of the worst losing periods to -4.8%. Again, the average 5-year return is 11.9%.

TIME IN THE MARKET IS MORE IMPORTANT THAN TIMING THE MARKET

A common refrain is that the stock market is a casino. If so, it is a strange one where the odds are clearly in your favor over longer periods of time. Of course, past performance is no indication of future results, but history tells us that an investor wins 100% of the time with a 15-year time horizon.

Below we have parsed 50 years of S&P 500 returns into different time periods. The key takeaway from this chart is that staying invested over the long term substantially reduces the chance and magnitude of loss.



PERSPECTIVE AND A LONG-TERM FOCUS IN THE FACE OF UNCERTAINTY

If we better understand the frequency and magnitude of these selloffs, we become more capable of managing through such challenging periods. When confronted with global or economic uncertainty, it can be difficult to imagine what the next year or even the next month will bring, and that is scary, especially when it coincides with sharp declines in the stock market. However, it is important to maintain perspective and a focus on the long term to achieve your investment goals. We hope this piece will provide some comfort and guidance for you not only during this unsettled period, but during future ones as well.