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Myths in Stock Market Advice – Part 2

DISCLAIMER - I am not a Financial Advisor and do not work for any Brokerage Firm. The opinions given are my own and are not to be used as professional advice. These are my findings and can hopefully help you make informed investing decisions. Consult a Broker or Lawyer before making any investment.

Those of you who have been following my blog and articles for several months, know my reason for doing this is to share some of my findings in investing in the stock market. I want to help everyone to make good solid decisions when it comes to investing. My first 40 articles have been tied to things that have worked for me or promising new things I am trying this year. The reality of the situation is that I can only share what I know to be the truth.

I wrote my first article on myths last week. I want to continue on that first topic today and again document some of my findings from the 3

books I mentioned in that first article. I may write several articles on Myths as I keep finding more and more fallacies in stock market advice. A lot of unscrupulous people are taking advantage of the uneducated.

To read article one on myths, click below:

https://lifecanbesimple.net/blog/myths-in-stock-market-advice

MYTHS IN STOCK MARKET ADVICE

Last week we started with the fallacy of believing in an average 12% annual return in the stock market, and I want to elaborate on this topic a bit more this week. A lot of people teach that the stock market will average out to a 12% annual return so don't have to worry about where you invest, just invest it consistently, and it will work out.

WRONG!!!

This is so prevalent a teaching that even I have been guilty of using this to encourage people to "Just Invest" no matter the market. I can't overemphasize the importance of knowing the market and knowing WHAT to buy and what to avoid.

In the book "Stop Investing Like They Tell You" by Stephen Spicer, a CFP (Certified Financial Planner), he points out the fallacy of believing the S&P 500 will always average a 12%

annual return.   Note: On this next image, you can read this better in a browser than on your phone.

MYTH 1 “The Stock Market Averages 12% Per Year”

The Market

First off, we should probably define “the market” as there are, in fact, many markets in the world of investments. In most cases—in most finance-themed conversations where “the market” is mentioned—people are referring specifically to the *stock*[13] market.

The S&P 500

The S&P 500 is the benchmark by which most investors measure. Made up of the 500 largest US companies—representing roughly 80%[14] of the total US stock market—this index[15] is one of the most representative of the US (and world, for that matter) economy in general.

Originally consisting of 90 of the largest companies in the United States, Standard & Poor’s started tracking this index back in 1926. In 1957, it was expanded to the 500-company composite we recognize today.

Here’s the year-by-year return breakdown.

Table 1

S&P 500 Historical Annual Returns

1926	11.62%	**1936**	33.92%	**1946**	-8.07%	**1956**	6.56%	**1966**	-10.06%	**1976**	23.84%	**1986**	18.67%	**1996**	22.96%	**2006**	15.79%	**2016**	11.96%
1927	37.49%	**1937**	-35.03%	**1947**	5.71%	**1957**	-10.78%	**1967**	23.98%	**1977**	-7.18%	**1987**	5.25%	**1997**	33.36%	**2007**	5.49%	**2017**	21.83%
1928	43.61%	**1938**	31.12%	**1948**	5.50%	**1958**	43.36%	**1968**	11.06%	**1978**	6.56%	**1988**	16.61%	**1998**	28.58%	**2008**	-37.00%	**2018**	-4.38%
1929	-8.42%	**1939**	-0.41%	**1949**	18.79%	**1959**	11.96%	**1969**	-8.50%	**1979**	18.44%	**1989**	31.69%	**1999**	21.04%	**2009**	26.46%	**2019**	31.49%
1930	-24.90%	**1940**	-9.78%	**1950**	31.71%	**1960**	0.47%	**1970**	4.01%	**1980**	32.42%	**1990**	-3.10%	**2000**	-9.10%	**2010**	15.06%	**2020**	18.40%
1931	-43.34%	**1941**	-11.59%	**1951**	24.02%	**1961**	26.89%	**1971**	14.31%	**1981**	-4.91%	**1991**	30.47%	**2001**	-11.89%	**2011**	2.11%		
1932	-8.19%	**1942**	20.34%	**1952**	18.37%	**1962**	-8.73%	**1972**	18.98%	**1982**	21.55%	**1992**	7.62%	**2002**	-22.10%	**2012**	16.00%		
1933	53.99%	**1943**	25.90%	**1953**	-0.99%	**1963**	22.80%	**1973**	-14.66%	**1983**	22.56%	**1993**	10.08%	**2003**	28.68%	**2013**	32.39%		
1934	-1.44%	**1944**	19.75%	**1954**	52.62%	**1964**	16.48%	**1974**	-26.47%	**1984**	6.27%	**1994**	1.32%	**2004**	10.88%	**2014**	13.69%		
1935	47.67%	**1945**	36.44%	**1955**	31.56%	**1965**	12.45%	**1975**	37.20%	**1985**	31.73%	**1995**	37.58%	**2005**	4.91%	**2015**	1.38%		

To calculate a simple average, we just need to add all these returns together and then divide by the number of years (95). This calculation reveals that from 1926 through the end of 2020, the S&P 500 has averaged a 12.1% annual return.

Boom!

There you have it. Case closed! Twelve percent per year is what you should expect in the market. And look at my-old-financial-planner-self from earlier taking care of you by presenting such a conservative bar for your expectations— with my 6%, 8%, or even 10% projections.

It’s true: the simple average of the market’s annual returns comes out to 12.1%!

An advisor trying to bring his point home might continue with, “And sure, everyone knows that the stock market falls sometimes. Right? But until 2008, it had never realized a negative annual return over any 10-year period, and even then, that was only a 1% average annual loss.”[16] They could continue, “And when averaged with the decade prior, you would have realized a respectable 8% annualized return. Pretty great how that works out, right?!”[17]

I started my career with one of the largest financial planning firms in the country. I was trained to show people that over any 15-year period, the stock market has *never* lost money! (Over the last 95 years at least.)[18]

Figure 1

S&P 500 15-Year Annualized Returns

Note: Average annual returns for the 15-year periods ending in 1941 (1926–1941) through 2020.

Before the crash in 2008, one could have created compelling marketing material making a similar claim except for every 10-year period. Note how easy it is to manipulate statistics: when the 10-year data are no longer helpful to prove a point, a slight adjustment can be made in order to continue selling the same story.

All these numbers are true. And if my goal was to just convince you that you should invest in the market and let it ride no matter what—that buy-and-hold strategy (which we’ll debunk soon[19])—these data present a compelling case. It especially does so for the everyday investors who are not really interested in, and don’t have the time to, thoroughly read between the lines. They just want someone they can trust to help them know what meaningful action they should take today in order to most efficiently achieve their goals as soon and as *safely* as possible.

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So many teach that by simply adding to your investments each week, by the use of dollar cost averaging everything will work out fine in the long haul.   Now if you are in a mutual fund that is a ‘Target Date Fund’ set to the year you will retire, there might be some logic to this approach.   But simple ETF investing in full stock market indexes is not enough.

The reason that dollar cost averaging sounds so good is that you get more shares when stocks go down and fewer as the prices increase.   The kicker is that just because the stock market did average that 12% over the past 50 years, you must question if that will repeat itself.

Market Averages 12% Per Year”

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S&P 500 Historical Annual Returns

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History does tend to repeat itself, but do you want your retirement funds based on a ‘Maybe it will approach?’ Will you be able to invest and leave the money alone for 50 years? I doubt any of us will ever invest in the same investment for 50 years.

That 12% per year average sure sounds good. I mean who would not like that? Unfortunately, there were several 10-year periods in the last 50 years where the average was less than 3.5% average annual return. And twice there were ten-year periods showed a negative return. If you are like me at an older age, you can not afford a negative return.

The reality is we all best assess our situation based on our age and projected retirement date, and as we get near retirement, get super conservative.

Warren Buffet said his number one rule was “Don’t lose money in the stock market.” And Rule 2 is don’t forget number 1.

There are a few safe investments, but there are many that can lose money. Most people think you can quickly regain a

30% loss. Not so. The reason is you lost 30% of your base investment, so it takes more like a 43% gain to make up for a 30% loss. Look at the graph below to show what losses require to just break even.

Loss Incurred	Gain Required
10%	11%
20%	25%
30%	43%
40%	67%
50%	100%
60%	150%
70%	233%
80%	400%
90%	900%
95%	1900%
99%	9900%

So if you lose ½ of your money, now to break even, you must have a 100% return. How many of you ever made a 100% return in your IRA or 401K? I have been investing for 30 years, and I think my best year ever was 22%.

So our number one goal should be to never lose money. Not easy when you are trying for above-average gains, but there are logical ways to proceed cautiously.

My new goal is to limit all stocks and ETFs to an 8% loss by using stop-loss orders. After we hit a bottom in the market, I buy back in, sometimes on the same stock or ETF. But I try to not ride out a 25 to 40% down market. It is extremely hard to ever overcome. And there will be some upcoming myth articles about when the market did much worse than lose 40% in one day (more than once).

Using this stop loss orders method for the last 4 months, my wife and I now have an overall gain of around 3% on all five of our Roth IRAs for the year. That is so much better than the current 26% loss in the S&P 500. While my new Dividend Growth Stock approach is unproven, the majority of those stocks are in my Schwab account which is up 8.6% for the year. At Vanguard where we are primarily in full stock market indexes and real estate (REITs) and ETFs on Dividend Growth Stocks, we are up 6.8%.

Our two Wealthfront IRAs are managed by Wealthfront, and both are about 1% up for the year. These are heavily conservative with balanced investments in all markets and some foreign bonds and foreign stocks.

So as far as the advice to never bother or consider the markets, I think we know that is bad advice. I am not advocating not putting money into investments in down markets, but I am advocating placing new money to Savings accounts, Bonds, CDs, Tips, and I-bonds until the market downturns bottom out.

Capital One 360 Savings have high-velocity savings paying 3% per month and Discover Savings is also paying 3%. I saw today that Credit Karma has a savings account paying 3.3%, but have not researched it. I purchased a six-year CD in my Fidelity Roth IRA this week which is paying 5.05% and 4 year one paying 4.8% that is not callable. Conservative options abound during this bear market as we face the possible 2023 recession.

A Few More Myths:

The United States has the highest tax rates in the world. Not true!

Mutual fund myth: Don't worry about low one or two-percent fees on Mutual Funds. False again. Just a one percent fee can reduce your long-term return up to 28%. A two percent fee can lower your long-term return by as much as 63%. Fees matter.

Another hot tip myth: When things take off on whatever is hot now, jump in without regard to verifying the value of the investment. Extremely stupid advice. History is full of "The Greater Fool" stories where euphoria takes hold and cost does not seem to matter to investors. Cost and value ALWAYS matter. I think Amazon's P/E ratio is far from 8 to 1 as is desired. I think I read it is more like 1400 to 1. Does that make it a bad investment? Sounds risky to me, but many people got rich buying Amazon when it started. But now is not then.

Warren Buffet warns to “Be Fearful when others are greedy, and greedy when others are fearful.”

The key to this advice is to buy when prices are down and the market is stabilized. Then when the market is high, consider selling when the stock or ETF has exceeded a fair value. I personally try to minimize buying and selling, but huge gains sometimes are a good time to at least recover your initial investment. High prices typically do not last forever.

Myth: Financial independence and the ability to retire early (FIRE) is easy to obtain.

Financial Independence means you are earning enough that your investments are making more than your annual costs in perpetuity.

The reality is this is very hard to accomplish. You can not expect an average of 12% per year, and you may not average 8% per year. If you need $50,000 of income yearly, you must accumulate $700,000 (or more) to sustain your retirement expenses based on an 8% return which is never for sure.

So take these findings and learn to make better decisions. Keep reading and studying on your own. I will do another Myths article in the upcoming month. If you are a serious investor, be sure to read the 3 books I mentioned in the first article which is below.

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