

The AVERAGE Advisor

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The markets provided great returns for 2009 which was good because they were awful in 2008. When you look at the broad picture volatility still rules the day. In the investment world we often hear absolute terms and phrases that rarely prove true in our actual experiences. In the late 90's you might have heard an investment advisor or market analyst say that if you hold stocks for 10 years or more you would see average returns of around 10%. While that might have been true of the past 10 years it was not true for the next 10. What matters is when you put money in, when you took it out, and what strategy you were following along the way. I want to use the past two years to give you an example that will show the effects of volatility and how averages can fool us.

Suppose that you began 2008 with \$1,000,000 invested 100% in the Dow Jones Industrial average. At the end of 2008 your \$1,000,000 would have been worth \$660,000 because the DJIA lost 34% that year. Through November, the DJIA is up 19.02% for 2009 so now your investment, after a great year of returns, is up to \$785,532. The average "annualized" return based on these numbers would be -11.36%. So while the market gave us some back in 2009 we still have a ways to go before the stock market can get back to zero.

Now look at how averages can mislead. If you take a -34% return and a 19% return and average them over two years your average percentage return is -7.5%. Using the example above, in 2008 using the average say we lost 7.5%. At the end of the year you would have had \$925,000. Then take off another 7.5% in 2009 and you end with \$855,625. This is much better than the \$785,532 that you actually ended up with.

Two Lessons:

1. Consistent returns (base hits) are much more powerful long term than hitting a solo home run after two strikeouts. The difference between you and the baseball player is when you swing for the fence with your investments, you can lose runs you have already scored!
2. An average does not tell us how you performed unless it is an annualized average and includes additions and withdrawals over the time period. A regular mathematical average does not show the damage that losses can do to a portfolio and the time it takes to recover.

As with secular bear markets of the past (using Crestmont Research [chart](#)), we expect high volatility in stock markets to last for years to come. Our prediction for broad stock markets is that we will see good years followed by bad years but in the end look back and have gone nowhere. We have much to unwind and it will take a while to improve measures of the economy that have to be in place to see true economic growth. Therefore, our goal for 2010 and beyond is to seek out annualized returns of 5% or better without taking on undue risks for clients.