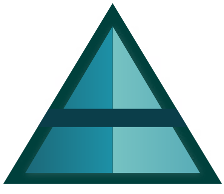


SOUND **INCOME** STRATEGIES, LLC

The secret to a great retirement is our middle name

Demystifying Wall Street Myths

5 Major Myths Debunked Inside!

- **Is the next major stock market dip right around the corner?**
- **Do stock market investments really outperform all other asset classes?**
- **Historical stock market patterns that repeat so consistently, you'll wonder why your advisor hasn't mentioned them to you.**

Your Guide to Making Sense of Wall Street Double-Talk

By David J. Scranton, CLU, ChFC, CFP®, CFA, MSFS

Did you know that for many years, investing in stocks was considered too risky for the pension fund portfolios of many cities, states, and countries? It was so risky that it was expressly prohibited in most cases. Instead, municipalities had a list of acceptable investments. The list varied from state to state, but it was usually comprised of fixed-income investments such as government bonds and high-quality corporate bonds.[1]

Although stocks were once considered too risky for many pension funds, it never ceases to amaze me how many advisors continue to recommend risky stock market investments for the portfolios of those who are close to retirement age. It also amazes me how many investment brokers appear unable or unwilling to accept the valuable lessons that stock market history has taught us.

In this report, I will share with you some information that has been closely guarded by Wall Street bankers. I originally shared these truths with the public in 2011 with the release of my first book, *Financial Insanity: How to Keep Wall Street's Cancer from Spreading to Your Portfolio.*

When I sat down to write the book in 2009, the stock market had just experienced a major drop precisely in line with the historical market trends I describe in this report. It was the second major drop since 2000. And, while it came as a surprise to many investors and cost them dearly, it was no surprise to me, and it didn't damage my portfolio – nor did it harm the portfolios of many of my clients.

As you'll learn, these catastrophic slides usually don't stop at two. Every long-term secular bear market cycle throughout history has experienced three or more drops. Our current cycle, which began in 2000, has only experienced two. Which means there's a good probability that we will experience a third bear market in the near future. And, if you are in or within 10-15 years from retirement and you get caught in this third major drop, the results could be disastrous to your retirement dreams.

In this report, we'll cover a few of these patterns that have repeated themselves so consistently throughout stock market history, you'll wonder why your financial advisor hasn't shared them with you.

By better understanding these historical patterns, you'll be better prepared to sort through the Wall Street hype and instead focus on strategies that can help you avoid damaging losses.

Myth #1: *"Over the long run, the stock market outperforms other asset classes."*

Before we get into the numbers behind stock market history, let's talk about why you should be careful when being presented with "averages." I have a client who has a great sense of humor who, about 15 years ago, during a review meeting in my office, wanted to illustrate to me his concerns about averages and how averages could be misleading.

This fellow was a bit overweight, and my impression was that he was pretty sedentary in terms of his lifestyle. He said to me, "My wife and I jog an average of 10 miles per week." Of course, I didn't want to contest that in any way, so I nodded my head in approval. He responded by saying, "my wife jogs 20 miles a week, and I don't jog at all, so

you have to be careful about averages because they can be misleading." And, just like that fellow's sense of humor, the reality is that the same is true when it comes to stock market averages.

We often hear that the total return the stock market yields over the long run is around 9% or 10%. So, let's say 10% because it's a nice round number that's easy to work with. History shows that over the long run, 2% to 3% of that return ends up coming from stock dividends and 7% to 8% end up coming from growth or capital appreciation in the stock market. That 7% to 8% is an average growth rate over the very, very long run.

The way this 7% to 8% average breaks down over the long run is that there are huge periods of time where the market experiences a lot of volatility and results with zero growth. Then, there are huge periods of time where the market does very well, averaging over 10%, often in the range of 12% to 15% average growth rates.

So, let's look back at the last century or so to examine these trends. From 1899 to 1921, based upon the most commonly available stock market indicators at that time, the stock market experienced tons of volatility, good years mixed in with bad years, but the good and bad years ended up washing each other out, resulting in a period of zero growth for buy-and-hold stock market investors during that 22-year period.

Then, from 1921 to 1929 the market did incredibly well. This eight-year period was representative of the best decade we had ever seen in the stock market at the time—now second-best to the 1990s. Then, everything fell apart in 1929 when the stock market crashed.

Over the following 25-year period from 1929 to 1954, the market, once again, experienced lots of volatility, where the good years and the bad years washed each other out. It resulted in a 25-year period with zero growth for most buy-and-hold stock market investors.

Then, in the 12 years between 1954 and 1966, the stock market did incredibly well, and the United States was on top of its game. But then, in 1966, things started to turn. We entered a 16-year period from 1966 to 1982 where the stock market had good years, bad years, and a lot of volatility. Once again, the good years and bad years washed each other out and most buy-and-hold stock market investors achieved zero growth during this 16-year period.

The Dow Jones Industrial Average hit 1,000 in 1966, and in 1982, some 16 years later, it was still 1,000. Again, 16 years of zero growth.

Then, in 1982 the market took off and we had the best bull market in U.S. history, which lasted for 18 years. The Dow went from 1,000 to almost 12,000 over that period—a 12-fold increase in 18 years. Then, of course, everything turned starting with the year 2000 when the markets started to drop.

Do you see a trend here? The average secular bear market, according to 200 years of stock market history, is about 20 years. And, the average secular bull market seems to last about 15 years. If we look at a bull market and attach it to the adjacent bear market, history shows that it takes about 35 years for the market to go full cycle.

So, if you have money that you know you won't need for 35 years, you *should*, in theory, be able to put that money into the stock market and have it outperform most other investments. The problem for most people is that they probably have very little money on their balance sheets that they know they're not going to need in the next 35 years.

Truth behind Myth #1 for stock market investors who stayed invested in the market from 2000–2017:

Since the turn of the century, fixed-income investors have achieved an average return that is very similar to, if not slightly better than, buy-and-hold investors whose portfolios matched the performance of the S&P 500 Index and averaged around 4.75 percent from 2000 through the end of 2017, with dividends factored in and after accounting for inflation.[2]

By comparison, many fixed-income investors whose portfolios have been properly managed have achieved close to 5 percent income and greater than a 5 percent total return.[3] Plus, they've done it with less risk of a major loss during the two major market corrections that occurred between 2000 and 2009.

Myth #2: *"The stock market gives back just as easily as it takes away."*

Have you ever thought about what percentage return you would have to earn to recover from a 25% loss? For example, if you were to start with a dollar and lose $0.25, then the remaining $0.75 would have to grow at 1/3, or 33% just to get back to where you started.

What about a 50% drop? If a dollar were to drop to $0.50, that $0.50 would have to double to get back to a dollar. You would need a 100% gain just to get back to even!

If you lost 50%, and you earned seven percent per year, it would take you 10 years to fully recover. If you were able to earn 10 percent, it would take you seven years to recover, during which time you would have achieved zero growth. After accounting for inflation, your wealth would have actually *regressed*.

Remember: Losing money or breaking even in the stock market also means you have missed opportunities to achieve growth or generate income with other investment strategies.

Unfortunately, this is not a hypothetical situation. It has happened to domestic investors twice since the turn of the century. From the beginning of 2000 through March of 2003, the stock market, based upon the Standard & Poor's 500 index, dropped almost 50%. It took until October 2007 to recover. After riding out the stress of the markets for these seven and a half years, most buy-and-hold stock market investors were right back to where they started.

Then the shoe dropped again, and this time, the market came off its peak in October of 2007 and dropped by more than 50%. By the end of 2010, it had made an almost 100% growth rate from the bottom in March of 2009 to get back in the range of where it had been at its previous peak in October of 2007.

So, from 2000 to 2011, buy-and-hold stock market investors watched their retirement savings fluctuate in value and had to deal with the stress of these ups and downs for a net result of zero growth. Hardly seems worth it, especially for those who are retired or within 10-15 years of retirement.

Truth behind Myth #2:

"Those who don't know history are destined to repeat it."
— Edmund Burke, Philosopher and Statesman

Some of you might be wondering how it was that so many intelligent investors failed to liquidate in 2007 after recovering their losses? For some, it might have been a misguided sense of optimism. In other cases, perhaps their investment advisor was filling the role of a misguided cheerleader.

Think about it…as you recovered your losses, did your investment broker call to tell you to take your gains? Or, did they somehow give you the impression that the market would go even higher?

Then, as the market began to drop again in 2008, did they again suggest that "you should hang in there because we're at or near the bottom?" As the market dropped even further, were you wishing you had followed your instincts and cut your losses?

As we have seen, history does indeed seem to repeat itself, and many investment brokers appear either unable or unwilling to accept the lessons of history.

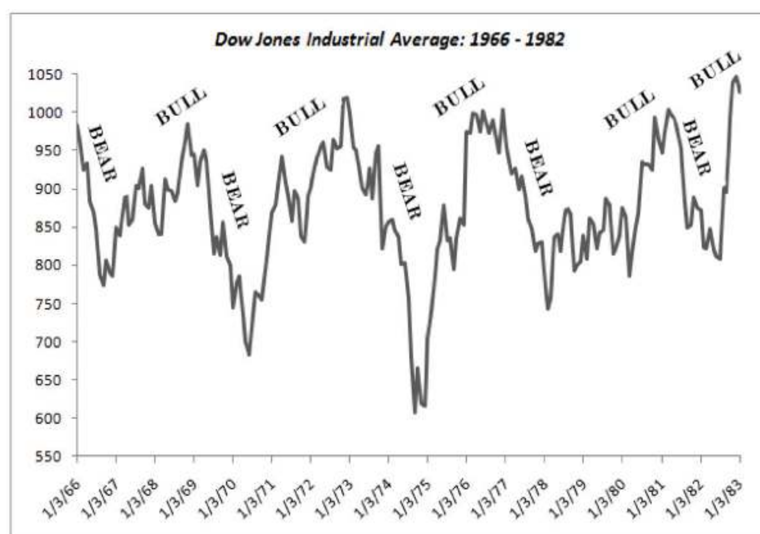
Myth #3: *"A Bear Market Lasts Just Two to Three Years."*

Wall Street loves to use complicated language that can overwhelm the average investor. One area where Wall Street and the media seem to give different versions of the truth is when it comes to talking about bear and bull market cycles. When you watch market analysts on TV, they generally imply that a bear market lasts just two to three years.

But, as we looked back through nearly 200 years of stock market history, it was easy to see a pattern where most secular bear markets typically run 15 to 20 years or longer. So, which is right?

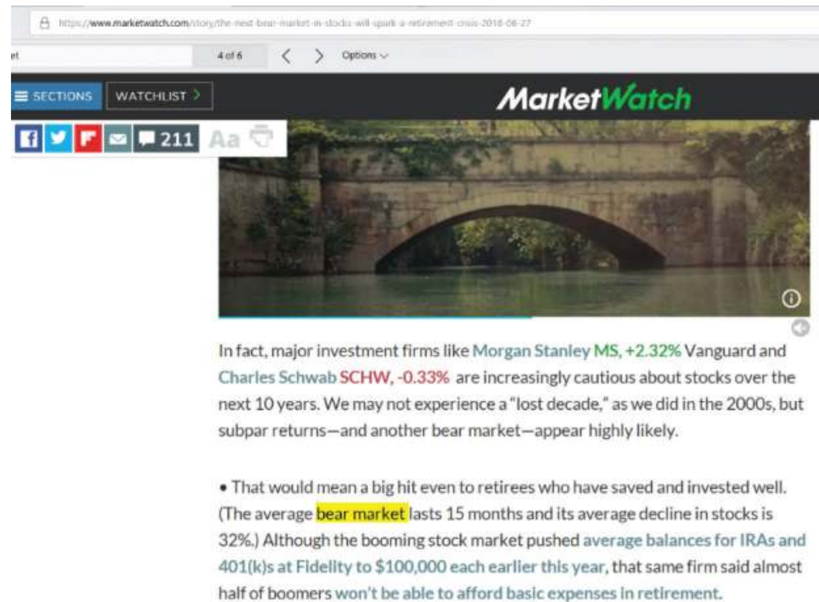
The answer lies in the differentiation between the terms *Secular* and *Cyclical*.

The term secular is used to describe longer-term market cycles. Within each secular bull or bear market, there are shorter cyclical cycles. The cycles labeled in the following graph are what typical analysts would call textbook bear and bull markets, even though they occur within the longer-term secular bear market.



"I have never lied to you. I have always told you some version of the truth."
— Jack Nicholson as "Harry" in the movie, *Something's Gotta Give*

As I was writing this report, I found an example of how the media can sometimes use different versions of the truth to make their case. In the image below, you can see they reported that "the average bear market lasts 15 months…" without clarifying that they were referring to a cyclical bear market.[4] So, they aren't necessarily lying, just giving you a different version of the truth that helps them make their case, without clarifying.



In fact, major investment firms like Morgan Stanley MS, +2.32% Vanguard and Charles Schwab SCHW, -0.33% are increasingly cautious about stocks over the next 10 years. We may not experience a "lost decade," as we did in the 2000s, but subpar returns—and another bear market—appear highly likely.

• That would mean a big hit even to retirees who have saved and invested well. (The average bear market lasts 15 months and its average decline in stocks is 32%.) Although the booming stock market pushed average balances for IRAs and 401(k)s at Fidelity to $100,000 each earlier this year, that same firm said almost half of boomers won't be able to afford basic expenses in retirement.

Truth behind Myth #3:

So, why is it that Wall Street and the media prefer to speak in terms of textbook cyclical cycles instead of real-world secular cycles? Well, how likely would you be to invest in the stock market if Wall Street told you a bear market was upon us and would persist for years?

Simply put, focusing on shorter-term cyclical cycles allows Wall Street to speak optimistically more often. Wall Street cheerleaders know that people are more likely to invest when they are optimistic and think the markets are going up.

Myth #4: *High P/E ratios are not a reason to worry.*

Why was I so confident about my predictions in the late '90s? Because I had an understanding of a stock market staple: price-to-earnings ratio. Every stock has a price-to-earnings ratio, as does the entire stock market. The formula is relatively simple:

P/E = Price per Share/Earnings per Share

As a general rule, if you are comparing two stocks in the same industry, the one with the lower ratio is probably the better "buy" because it is considered to be "undervalued."

Average P/E ratios of stocks in the overall stock market can also be a good indicator of when stock market levels are generally too high and ready for a drop. This was the case in the late 1990s when average P/E ratios had exceeded

30. In other words, each dollar invested was buying 3 cents of earnings or annual profits. Put another way, you were earning about 3 percent when you could have taken the same money and invested it in an FDIC insured CD that carried no risk and was paying 5%.

What does history tell us about P/E ratios? When we've come to the end of a secular bull market like the one in the late 1990s, P/E ratios are typically in the upper twenties or above 30. Historically, this is a signal that we are about to slide into a secular bear market that could last 15-20 years or longer. At the end of a secular bear market, P/E ratios typically slip below 10, often into the 6-8 range. Historically, this signals the beginning of the next secular bull market cycle. A big reason why secular bear markets end up lasting 15-20 years is because that's how long it typically takes for P/E ratios to drop from over 30 into the 6-8 range.

So, you might wonder what the current P/E ratio of the stock market is. According to multpl.com, the current P/E ratio of the S&P 500 at the end of June 2018 was around 24.93. The current Shiller P/E Ratio, invented by Professor Robert Shiller of Yale University, was 31.8 at the end of June 2018.[5] The Schiller P/E ratio is thought to be a more reasonable indicator of market valuation than the standard P/E ratio because it eliminates fluctuation of the ratio caused by the variation of profit margins during business cycles.

Truth behind Myth #4:

"Price is what you pay. Value is what you get." — Warren Buffett

To illustrate how ridiculous it is to purchase a stock with a P/E ratio of 30 or more, let's consider the following: You have decided to purchase an ice cream parlor business. The owner wants $3 million for the business. After looking over the books and records, you discover the business makes $100,000 annually. In other words, the business's P/E ratio is 30. This means that it would take you 30 years to recoup your costs. Keep in mind, you could have bought government bonds with your $3 million, and you would have earned more without having to scoop a single serving of ice cream. Would you consider this ice cream business a viable investment? Most would say no. Yet, many don't think twice before risking their retirement savings in a market with the same P/E ratio.

Stock Market Myth #5: *"This time, it will be different."*

Often, when faced with data that contradicts what Wall Street wants its clients to believe, many stock brokers will simply tell their clients, "Don't worry. This time, it will be different."

It is my hope that after reading this report, you'll be armed with enough facts about stock market history that you'll be able to sort through the hype and focus on the facts that matter.

For example, throughout history, we've consistently had 20 years or more of bear markets, followed by shorter bull markets, followed by more bear markets, and so on and so forth. In 2013, the stock market finally broke through its ceiling that had existed since the year 2000. Normally, that would imply that we've exited the secular bear market cycle and entered into a new secular bull market. However, many experts question that, as they point to the unprecedented level of artificial stimulation (Quantitative Easing) that caused it.

So, is it possible that this is the first time in nearly 200 years of history that the stock market recovers after only 13 years? Well, of course it is; anything is possible. Hopefully, what you're asking yourself right now is, is it probable? According to market history, the answer is no.

It's also worth mentioning that *every secular bear market we've seen in history* has had three or more major drops. Since the turn of the century, we have only had two. So, the big question then becomes, when will the third drop happen, and how precipitous will it be?

Truth Behind Myth #5:

> *"Insanity is doing the same thing over and over again but expecting different results."*— Albert Einstein

We've never exited a secular bear market in less than 13 years. We've never seen a secular bear market end with less than three major drops, and we've only seen two major drops thus far! If the analysts are right, and we're entering into a new secular bull market, that means we're currently poised to break two Guinness Book of World Records at the same time!

Finally, let's recall the P/E ratio of the stock market as a whole. As we mentioned earlier, historically, when we're about to end a secular bull market cycle, P/E ratios end up in the upper 20s or higher. However, we've ***never*** recovered from a secular bear market cycle until P/E ratios were in the single digits. Where are they now? Somewhere between the upper 20s and lower 30s.

So, with the probability of breaking three Guinness Book of World Records being highly unlikely, and with there being so much conflicting information about stock market cycles in general, those who are part of The Income Generation™—born in 1966 or earlier—need to realize that the onus is on them.

Now more than ever, you must keep yourself educated and seek advice from financial professionals that are dedicated to helping individuals and families meet their immediate and long-term financial objectives.

As I mentioned earlier, I originally shared many of Wall Street's closely guarded truths in 2011 with the release of my first book, *Financial Insanity: How to Keep Wall Street's Cancer from Spreading to Your Portfolio*.

More recently, I became an Amazon bestselling author with the book, *Return on Principle: 7 Core Values to Help Protect Your Money in Good Times and Bad*. In this book, I describe how you can learn to master Wall Street's "inside game." The book describes how you can protect your retirement savings from stock market turmoil through non-stock alternatives designed to generate reliable retirement income and provide reasonable, strategic portfolio growth.

In 2016, I started my own TV show, *The Income Generation*, which airs every Sunday at 10 AM on Newsmax TV. The show educates individuals on the importance of purpose-based investing, especially for those who are 10 to 15 years from retirement, or already in retirement. Here's a link to find out which channel you can watch my show on *https://www.newsmaxtv.com/findnewsmaxtv/*.

Financial Advisors Who Don't Specialize in The Income Generation May Not Have the Skills to Ensure Safe Passage into Retirement

Although Sound Income Strategies works with a wide range of clients, our advisors specialize in helping those who are part of The Income Generation, those born in 1966 or earlier. We have top-tier income specialists who are experienced at investing with methods that maximize income and growth while minimizing exposure to stock market risk.

If you are in or within 10 to 15 years of retirement, visit soundincomestrategies.com to find a local income specialist registered with Sound Income Strategies who can help reduce your exposure to stock market risk and help you generate consistent streams of income you can count on well into retirement. You can also give us a call at the number provided to schedule a free consultation with one of our advisors.

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The secret to a great retirement is our middle name.

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