

Spotlight on Long-Term Investing

In recent years, market volatility has caused some investors to abandon growth-oriented investments such as stocks, and in so doing, their long-term financial plans. While the impulse to react to such events can be hard to resist, there is ample historical evidence to suggest that ‘tuning out the noise’ and sticking with a well-conceived plan is a more rewarding strategy. In this issue of our Spotlight series, we highlight the importance of stocks for an investor’s portfolio and the merits of keeping a long-term perspective.

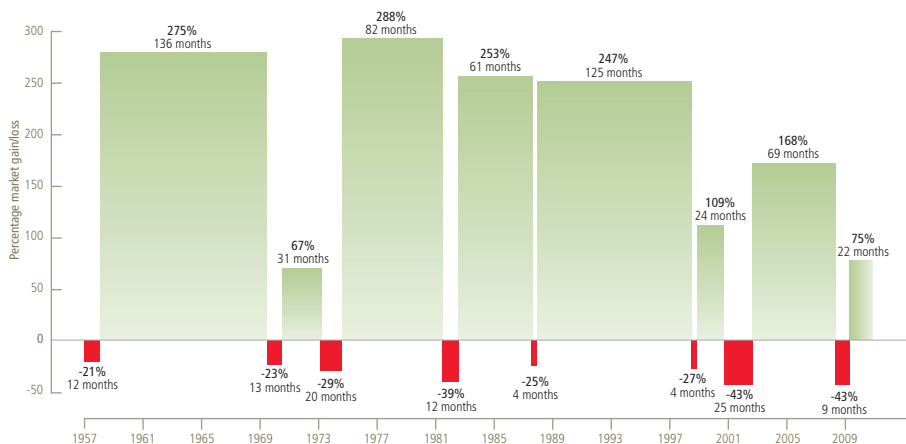
Bulls and Bears

Whether it’s the great crashes of 1929 and 1987, the oil crisis in the 1970s, the implosion of the dot com sector in the early 2000s, or the recent credit crisis, downturns have been a recurring feature of Canadian and international stock markets. But for every downturn, markets bounce back and typically with much greater magnitude and duration.

In Canada, this cycle of rising and falling markets – often referred to as ‘bulls’ and ‘bears’ – has occurred eight times since 1957 (see Figure 1). During this period, the average bull market increase was 185% over an average duration of 69 months. On the other hand, the average bear market decrease was 31% over an average duration of 12 months.

Figure 1

Bulls and Bears (1957 – 2010)¹



Did You Know?

The terms ‘bull market’ and ‘bear market’ are believed to originate from the fact that a bull knocks you up in the air (rising market) and a bear knocks you down (falling market).

¹ Source: Bloomberg. Month-end data derived from the S&P/TSX Total Return Composite Index (Jan. 31, 1957 – Dec. 31, 2010). Bull markets are movements in the stock market in which prices are rising and the consensus is that prices will continue moving upward. Bear markets are the opposite - stock prices are falling, and the view is that they will continue falling. In the above illustration, the generally accepted measure of a price increase or decline of 20% or more, respectively, over any given period, has been adopted. The above is for illustrative purposes only and not indicative of any investment, and assumes reinvestment of income and no transaction costs or taxes. An investment cannot be made directly into an Index.

Make Time Your BFF (Best Friend Forever)

Time is an investor’s best friend because it gives compounding the opportunity to take effect and smoothes out short-term market volatility.

To the question what is man’s greatest invention, Albert Einstein is reputed to have replied “compound interest”. Whether that was a joke or what the great physicist intended is an open question, but the message is clear: compounding growth over time is an investor’s greatest ally in seeking to accelerate the income and growth potential of their investments.

While market risk cannot be eliminated entirely, the more time you give your investments, the more you are able to mitigate the impact of short-term volatility, and to increase the certainty that you will achieve your objective. For example, for the period from 1960 to 2010, the annual compound returns of the Canadian stock market have swung significantly, ranging from 44.8% in 1979 to a low of -33.0% in 2008. Over a longer time period, however, the range of returns of a portfolio has been much smaller as the occurrence of negative annual returns reduced.

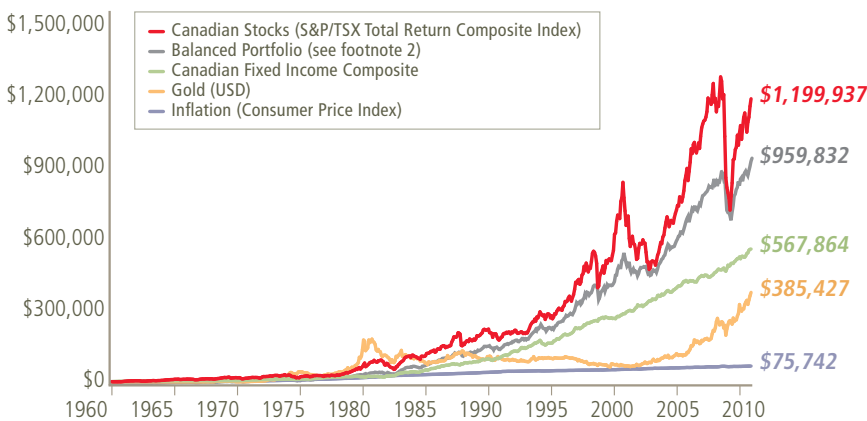
Moreover, long-term investors who also invest in a diversified portfolio – utilizing the benefits of asset allocation – can further smooth the impact of short-term volatility without dramatically affecting their ability to reach their goals.

But for those who start investing later in their life, time can be their worst enemy, especially if there is a significant or protracted market downturn. This can be potentially disastrous for investors approaching retirement, taking years to get back on track.

“Our favorite holding period is forever.”
 – Warren Buffett

Figure 2

Value of \$10,000 Invested in Various Asset Classes (January 1960 – October 2010)²



² Source: Morningstar Direct, Bloomberg. Balanced portfolio is 50% S&P/TSX Total Return Composite Index and 50% Canadian Fixed Income Composite – DEX Universe Bond Index proxy from 1960 to 1980 (75% Long Bond Index, 25% Mortgage Index) and DEX Universe Bond Index from 1981 to 2010.

Nothing drives home the importance of starting early and maintaining a long-term investing focus than a look at how stock markets have performed historically relative to other assets. Figure 2 shows how over a 50-year period – and despite some pronounced periods of short-term volatility – an all stock portfolio has vastly outperformed those of other asset classes.

Inflation – The Hidden Risk

While stocks and other asset classes carry the risk of short-term volatility to varying extents, purchasing power risk is an ever-present and arguably greater risk for all investors. That is to say, the impact of by which inflation erodes the current value of your investment over time. As illustrated by the Consumer Price Index line in Figure 2, in order to maintain the purchasing power of \$10,000 in 1960, your investment would have to have increased to over \$75,000 by 2010 – and you would still be no further ahead.

Like the fabled tortoise that beat the hare in the race, we can conclude that the investor who maintains a steady, long-term discipline is more likely to achieve their financial goals than the investor who chases performance and makes short-term decisions.

A Scotia advisor can help you with maintaining the discipline of long-term investing, and with determining a suitable allocation of growth investments and other asset classes for your portfolio.

Contact your advisor today

To find out more about long-term investment opportunities or visit us at scotiafunds.com



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