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Are Your Investments Giving You Long-Term Security?

By Gil Hanoch, March 7, 2007

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You probably know that stock investments can be very volatile. Even highly diversified stock portfolios have declined for several years and bottomed at 60% decline. These numbers are as irrelevant to a long-term investor as they are scary.

You should only put money in the stock market that you are willing to leave for a few years. If you can wait for 5 years to use your stock investments, the only measure that is relevant for you is the decline periods and magnitudes over 5-year periods.

The following table presents the worst performance of the globally diversified portfolio Long-Term Component by QAM during the years 1970-2009, over different time periods from 1 to 20 years. As a reference point, it compares this performance to the conservative bond portfolio, Short-Term Component by QAM.

Worst Period Length	Worst Period Performance, Annualized	
	Long-Term Component by QAM	Short-Term Component by QAM
1 year	-50%	-16.6%
2 years	-31%	-8.1%
3 years	-16%	-5.1%
4 years	-8%	-3.5%
5 years	-1.4%	-1%
10 years	6.2%	2.5%
15 years	5.6%	4.1%
20 years	9.3%	5.8%

The most notable thing is the improved worst case scenario, as we measure it over long periods. Specifically:

1. All 5-year periods had positive, or near positive, annual returns.
2. For investment periods as short as 5 years, the stock portfolio was almost as safe as the conservative bond portfolio! In periods of 10 years or more there was a clear benefit to the stock portfolio.
3. All periods of 20 years had high single-digit returns, even when including the worst years.

There are some very practical conclusions from this:

1. If you have to spend your entire investment in the next few years, stocks are volatile and a risky choice.
2. If you would like your investment to provide you annual income, for a period that can be potentially 10 years or more, a conservative approach would require putting most of the money in a globally diversified stock portfolio.

Note: This article analyzed a highly diversified stock portfolio that is rebalanced but otherwise is unchanged throughout all market conditions. The results are not likely to be true when using individual stock selection or market timing.

To Summarize

It is critical to keep money outside the stock market for substantial expenses that must occur within the next few years. Otherwise, when used correctly, stocks can be the most conservative investment vehicle at your disposal. Over most multi-year time horizons, diversified stock portfolios tend to provide positive returns and even handsome ones in all periods, including periods that include very severe recessions.

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