

Quality Asset Management

Grow Your Wealth with Peace of Mind

Part of my Salary is only \$10,000!

By Gil Hanoch, February 2012

Please read the following statements:

1. Part of my salary is only \$10,000. My salary is so low!
2. This car is really cheap – its doors and wheels cost only \$3,000!
3. My investments have done poorly. Over the past 10 years, part of the return was 0%.

Do you see a problem with these statements? They provide a judgment on partial information – a portion of a value. The full salary could be \$100,000, the car could cost \$50,000 and the investments could have doubled, in which case all of the judgments above are wrong.

While you may be confused reading such statements, the article that appeared on the front page of the business section of the Los Angeles Times, “The 3 Bears”, on January 8, 2012, made statements similar to #3 above.

I am not judging the quality of the referenced article as a whole (it had some good information), but a specific set of data that was presented in an eye-catching way in the beginning of the article.

The article showed 3 long time periods in which the price of the Dow Index did not go up much (or even declined in one case).

While the information is correct, it is not useful. The change in the price of an index or a stock represents only a part of the return to investors, since it ignores dividends.

The table below shows the calculated returns of the Dow Index based on the years presented in the article (price change only), compared to the total returns of the Dow Index (including dividends). The returns of the globally diversified portfolio offered by QAM, Long-Term Component, were added when available.

Period	Length	Annual Returns		
		Dow Index no dividends	Dow Total Return	Long-Term Component
1929 - 1950	22 years	-1.1%	4.2%	N/A
1967 – 1982	16 years	1.8%	6.6%	N/A
1970 – 1982 ¹	13 years	2.1%	7.1%	18.4% ²
2000 – 2011	12 years	0.5%	2.8%	8.8% ²

¹ This sub-period of 1967-1982 was added to compare to Long-Term Component, since its simulation started.

² based on simulated data.

You can see in the table that the total return of the Dow Index was substantially higher than the price-only return that was represented in the article. These total returns are not spectacular, but are significantly higher than the near 0% that was mentioned in the article.

Furthermore, I would argue that both measures are not relevant to a practical investor. There is no reason to invest in a concentrated portfolio of 30 of the slowest growing companies (being very large) in a single country that is the slowest growing country in the world (a result of it being the most developed economically). Instead, you can invest in thousands of stocks, large and small, all around the world. An example of such an investment is Long-Term Component, and you can see the significantly higher returns during these tough periods.

Last, while the referenced article emphasized the long stretches of poor returns for the price (excluding dividends) of certain stocks, it failed to mention that these periods all started with very high valuations (P/E ratios). Today, the P/E ratios are below average, meaning that we are not likely to enter a long period of poor returns for prices, even when measured excluding dividends.

Conclusion

I encourage you to be very careful of biases that appear in some articles. While these biases may get the attention of readers, they can create great financial harm to you, if you draw the wrong conclusions from them. A specific bias to be wary of is presentation of partial returns that do not include dividends.

Past performance may not be indicative of future results. Simulated data was used for periods prior to the inception of mutual funds (see [Performance Data Disclosure](http://www.qualityasset.com/disclosure.htm) at <http://www.qualityasset.com/disclosure.htm>). Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this article, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Note that services are limited to investment advice and do not include financial planning and/or non-investment related consultation services. You should not assume that any discussion or information contained in this article serves as the receipt of, or as a substitute for, personalized investment advice from Quality Asset Management. If you have any questions regarding the applicability of any specific issue discussed above to your individual situation, you are encouraged to consult with the professional advisor of your choosing. A copy of our current written disclosure statement discussing our advisory services and fees is available for review upon request.