

# The Price of Success



William Hammer, Jr.

By William Hammer, Jr.

**A**ugust was supposed to be a time for vacationing with family, enjoying the last days of summer, and getting the house ready for a Labor Day blowout bash. Unfortunately, the equity markets rudely punished us with a less than relaxing month.

The S&P 500 finished the month down almost 6%. One trading day covered a range of over 600 points in the Dow. And, as if that was not enough, Standard & Poor's downgraded our nation's debt.

With wild market swings seeming like the norm of late, we have to ask ourselves, "What is normal volatility?"

While volatility, in its truest sense, includes both downward and upward market movements, none of us are concerned with upward volatility—we worry only about market dives. (I am still waiting for my first client to call me in a panic when the market rises 4% in a day.)

But before you give up all hope in owning some of the greatest businesses on the planet, here are four numbers about the S&P 500 that might help to ease your mind.

**11.4%**

It's hard to believe, but that is the compounded annual return of the S&P 500 between 1980 and 2010. That includes the tech bubble at the turn of the century and the financial meltdown in 2008, by the way.

**\$2,550,091**

If Joe Investor had put \$100,000 into the S&P 500 in 1980 and not added or subtracted money through 2010, he would have multiplied his original investment by twenty-five times (assuming that he paid taxes from another source or enjoyed tax deferral). Even if you understand the miracle of compound interest, that number still has to blow your mind.

**24**

It's not just the television show that introduced us to Jack Bauer, that number is how many times out of 31 calendar years Joe Investor had more money on December 31st than he did at the beginning of that year. That's a batting average of close to 80%.

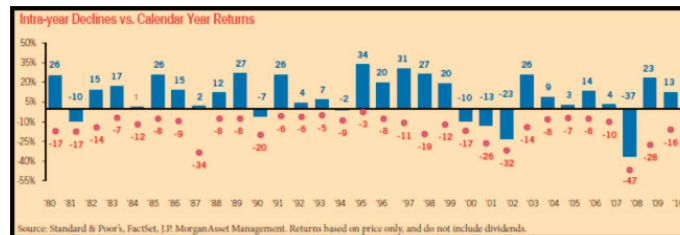
High returns and a lot of positive years, what's the catch? Here's where volatility plays a role.

**14.3%**

This number was the *average intra-year decline*\*\* of the index on a price basis only. In other words, at some point during the year, the S&P 500 dropped an average of 14% and caused emotions to run high. (By the way, if you included dividends, which the index never stopped paying at any time

during those 30 years, the average intra-year decline was less than 14%.)

What might surprise you is that intra-year drops of 10% or more did not always lead to a loss for the calendar year. As recently as 2009 and 2010, when large intra-year drops of 28% and 16% caused many investors to sell, there were still double-digit gains for those who stayed invested. There were even bigger gains for those who added heavily during these intra-year drops.



\*Note that the calendar year returns are in blue, while the intra-year declines are in red.

**In order to have multiplied your money by over 25 times over those 30 years, you had to see your account value drop 14% on average at some point during each calendar year and do something that may not have felt wise at the time:**

- You had to understand that temporary volatility is not permanent loss unless you panic and sell.
- You had to go against the grain and believe that this time was not different even though your portfolio dropped a lot more than 14% in some years.
- You had to remind yourself that premium returns come with premium volatility and major gut-checks.

None of us know when the next intra-year decline will occur, nor can we calculate in advance how large or small it will be. What we can be sure of, though, is that the media will portray it as the beginning of the end of the world. And when that happens, just remember that there are no substitutes for patience and perseverance.

\*\**Intra-year drops refers to the largest market drops over periods of six months or less.*



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