PRIVATE ASSET MANAGEMENT, INC.
WEALTH STRATEGY ADVISORS
PARADIGM

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Reviewing returns, the composition of returns, and inflation rates from the past 20 years provides valuable lessons that can be applied to the next 20 years. There are three main takeaways from this Paradigm. One: Solid 20-year returns occur in a very bumpy fashion. Two: The dynamism of American business is truly enviable. Three: Your future success is greatly influenced by factors that you control and that lie outside of returns.

Looking Back: Returns & Dynamism

We will look at returns with a simplistic focus on stocks (S&P 500), bonds (Bloomberg Barclays U.S. Aggregate Index), and inflation (Consumer Price Index). For the 20-year period ending December 31, 2017, the average annual returns and the average annual inflation rate were:

Stocks	7.2%
Bonds	5.0%
Inflation	2.1%

Here are several important statistics for each of the above figures.

Stocks.

1. Returns of 7.2% per year, compounded for 20 years, means that $1 grew to $4.02. Adjusted for inflation of 2.1% per year, it means that $1 grew to $2.65.
2. The S&P 500 **declined by over 50% twice** during this period.
3. The 7.2% return was composed of 5.5% earnings growth, 1.8% dividend yield and –0.1% from a declining P/E ratio.

Bonds

1. Returns of 5.0% per year are solid nominal returns.
2. Returns were negative only two years: 1999 (negative 1%) and 2013 (negative 2%).

Inflation

1. Inflation has been lower over the past 20 years than you might think.
2. Annual inflation never exceeded 4% during the period, was above 3% in only five years, and was negative once, in 2009.

We are not going to spend much time on events, other than to impress upon you how major the events were, and how economies and companies adjusted, survived, and thrived.

We are, though, going to offer one example for how much economies can change, yet still thrive. Let's look at the **current** five largest companies by market value in the S&P 500. They are Apple, Microsoft, Google, Amazon, and Facebook.

20 years ago, Microsoft would have been a major company in the index. Apple was in the index, but with a much smaller weighting. **The other three were not even in the index** and were added at various times in the 2005-2014 period.

The above attests to the dynamism of American business over time, a fact that is not likely to change.

Looking Forward: Returns & Factors That You Control

Last month, we noted that our expectation for average annual future returns was 7% for stocks and 4% for bonds. Not mentioned, but underpinning those expectations, was an inflation assumption of 2.5%. This implies lower nominal and real returns for both stocks and bonds, and a slightly bigger spread between stock and bond returns.

Not implied, but something you should mentally accept, is that the stock market is likely to decline by 50% at least once over the next 20 years.

There are factors besides returns affecting your success over the next 20 years. These are unique to your situation, especially when aggregated into a whole picture.

1. Your risk tolerance as expressed in your asset allocation. Simplistically, 100% stocks might return 7% while 100% bonds might return 4%. Your risk tolerance and expected returns are somewhere between those figures.
2. Understanding and controlling expenses, especially once you stop working for money, is crucial if your assets are to last past your lifetime.
3. Saving more helps, though this is likely to be more important the younger you are.
4. Working longer is sometimes an option. This factor has a new twist for those over 50. We see more articles and real-life situations that imply that some people might be better off financially and psychologically if they worked one to two more years instead of saving more and working fewer years.

Your situation is unique. However, twenty years of reasonable returns, coupled with addressing other factors that can increase your success should aid you in achieving your financial goals. We are here to help.

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