Financial Alternatives
integrated wealth management

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Executive Summary

- Stock and bond markets continued to rebound from the 2018 correction.
- Asset classes can have very prolonged downturns like what happened with the S&P 500 during the "lost decade".
- Diversifying into other asset classes like emerging markets and small company stocks would have mitigated losses during the lost decade.
- Just when investors begin to question the future viability of an asset class may be the point a reversal occurs—as what happened with US large company stocks after the financial crisis.

2019 and Beginning a New Decade

Major asset classes have continued their rebound from the 2018 year-end correction. Interest rates are expected to remain low in the near term, and worries about an escalating trade war have subsided. Please see our Market Review Newsletter for details on returns for investing markets around the world. As we close another decade of investing, we think it's important to reflect on lessons learned.

The first twenty years of the century have reinforced some timeless principles: Asset class returns can vary dramatically and unexpectedly from one period to another; broad portfolio diversification can help smooth out volatility; and keeping a focus on the drivers of expected returns can increase the potential for better outcomes. Developing a sound strategy—and sticking to it through good times and bad—can reward the long-term investor.

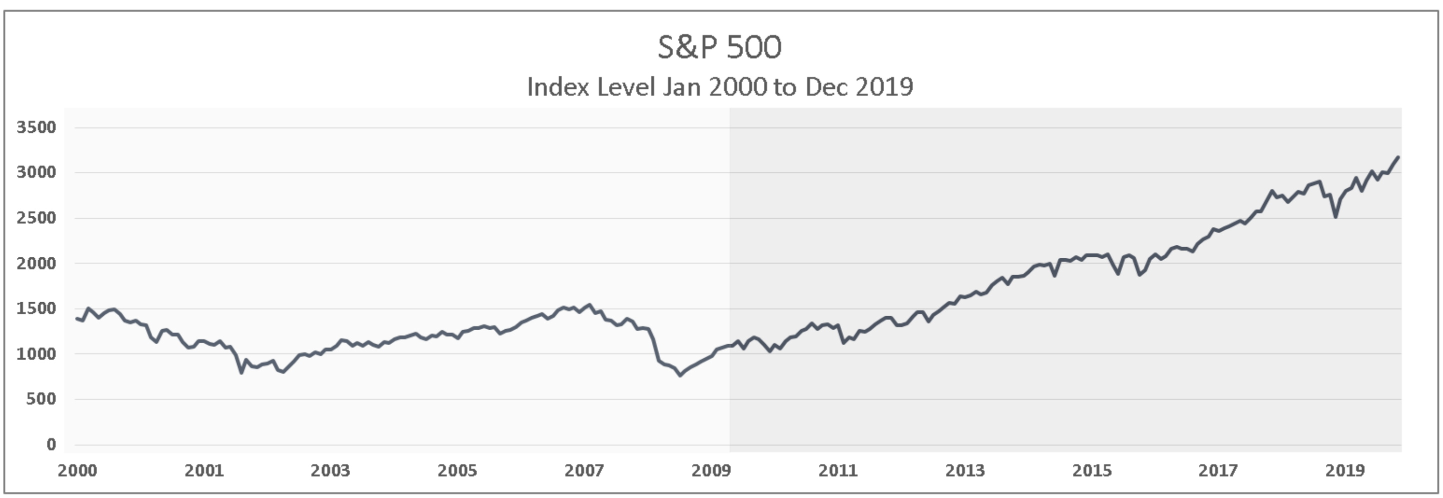
Remembering the Lost Decade

Looking at a broad representation of US large company stocks, such as the S&P 500 index, over the past 20 years, you could be forgiven for thinking of Charles Dickens: It was the best of times and the worst of times (see chart below). For US large company stocks, the worst came first. The "lost decade" from January 2000 through December 2009 resulted in disappointing returns for many who were invested in the securities in the S&P 500. An index that had averaged more than 10% annualized returns before the year 2000 instead delivered less-than-average returns from the start of the decade to the end. The annualized return for the S&P 500 during that market period was −0.95%.

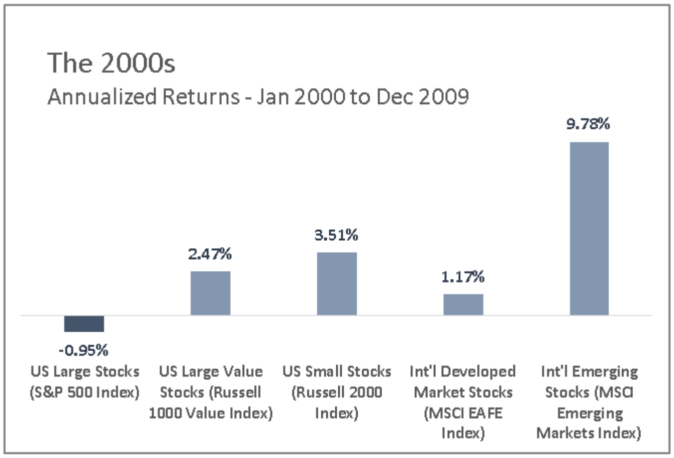
Yet it was actually a much better decade for investors who diversified their holdings internationally beyond the US and included other parts of the market with higher long-term expected returns—such as smaller companies or those with low relative prices (value stocks). As the 2000s chart on page 2 shows, a range of indexes across many other parts of the global market outperformed the S&P 500 during that time span.

The Reversal

The next 10-year period tells quite a different story. It looked more like best of times for the S&P 500, as the index has nearly tripled – excluding dividends! That is a tremendous bounce back from the depths of the financial crisis where the index bottomed in early 2009. US large

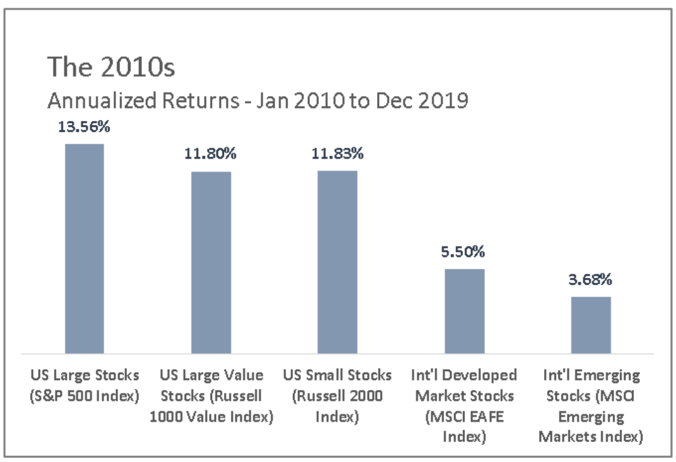


Source: Wall Street Journal



Source: S&P Data, Dimensional Fund Advisors

company growth stocks have been some of the brightest stars during this span. Accordingly, from 2010 through 2019, many parts of the market that performed well during the previous decade haven't been able to outperform the S&P 500, as the 2010s chart below shows. Since many of these asset classes haven't kept pace with the S&P 500, some investors may question their allocation to the very asset classes that drove positive returns during the 2000s.

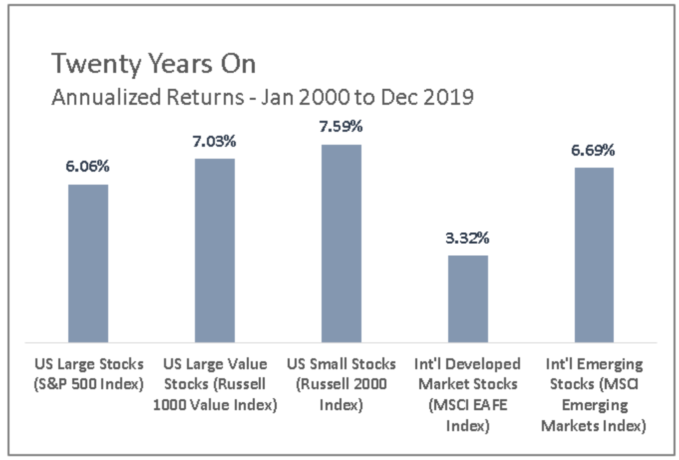


Source: S&P Data, Dimensional Fund Advisors

Market Expectations

We have stated many times that stock market investors should take a long-term perspective, and the performance of markets since the year 2000 supports this point of view. Over the past 20 years (see the Twenty Years On chart to the right), investing outside of US large company stocks has presented investors with opportunities to capture annualized returns that surpassed the S&P 500's 6.06%, despite some periods of underperformance, including the most recent decade. Cumulative performance from 2000 through 2019 also reflects the benefits of having a diversified portfolio that targets other - sometimes unpopular - areas of the market that have higher long-term expected returns, like as small and value stocks. The past 20 years also highlights the principle that longer time frames increase the likelihood of having a good investment experience.

No one knows what the next year will bring, let alone the next 10 years. Having a diverse portfolio requires patience and discipline, through the bad times and the good, but it puts investors in a better position to achieve long-term success.



Source: S&P Data, Dimensional Fund Advisors

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