MARKET OBSERVATIONS
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SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

The Long View

We are in a time when the pace of events seems accelerated. The high frequency of information conveys a sense of change and a felt urgency to respond. "This time is different" is the mantra for change that is both rapid and seemingly paradigm-shifting in nature. As a consequence, decision horizons may be compressed as the perceived cost of short-term indecision rises. A casualty of this accelerated pace can be the context of the long view. However, this context remains important. We turn here to the past 89 years. A perspective of this long view for some key economic and market measures can provide investment implications.

PERSPECTIVE

While not exact, economic activity, corporate profitability and stock market returns are linked. Annual rates of real (after inflation) growth for the U.S. economy are available since 1930 and plotted in Chart I. Recent headlines have focused on the acceleration of last year's economic growth to +2.9% and sequential increases over the past two years from an anemic rate in 2016. Nevertheless, annual growth has not reached the 89-year median rate since 2005. What has changed over time is the year-to-year variability of economic growth rates. From the Great Depression through World War II, annual economic growth rates varied widely. Variability lessened thereafter and has been notably lower since the Great Recession. Higher growth is preferred, but so too is lower variability.

Business both draws from and contributes to overall economic activity. A preferred measure of business success is real, after-tax corporate profits that are adjusted further for inventory valuations and capital consumption. Annual rates of profit growth are shown in Chart II. The historical median growth rate and year-to-year variability of profits are materially different from those of the overall economy. Variability has lessened from that of the 1930s through the 1950s. However, years of declining profits are not unusual, including three of the last six years. The impact of tax policy on profit growth was seen in 2018. The 16% rise in after-tax profits reflected in part a 33% reduction in taxes paid.

Stock market returns are related to the growth of corporate profits. Chart III displays both annual and rolling 10-year total returns for the Dow Jones Industrial Average. The growth potential from investing in stocks is clear with a median annual return of +10.2%. The risk of stock investing also is clear in the year-to-year return variability, which has lessened little over the past 89 years. Return variability does lessen over 10-year horizons and the frequency of gain rises to 94% versus 72% annually.

INVESTMENT IMPLICATIONS

The long view of economic activity, corporate profits and stock returns provides context for investing. It confirms that potential reward is not without potential risk, and that the view of both can change with time horizon. Prudent investing requires having a view as well – of goals, time horizons and risk tolerance. Without such a view, the pace of events may well lead to frequent, ill-timed investment decisions. With such a view, an investment course can be charted with an appropriate allocation to stocks and other assets, raising the likelihood of a successful outcome.

CHART I

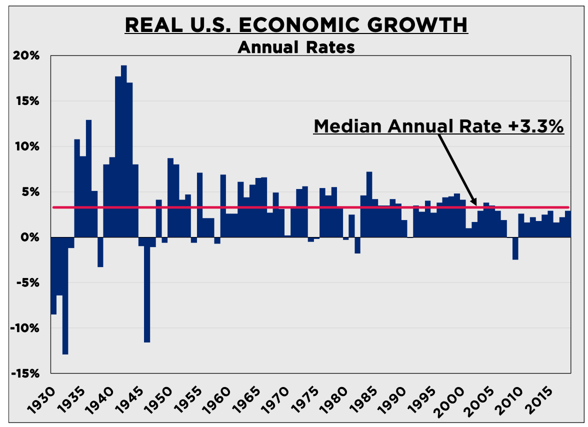

CHART II

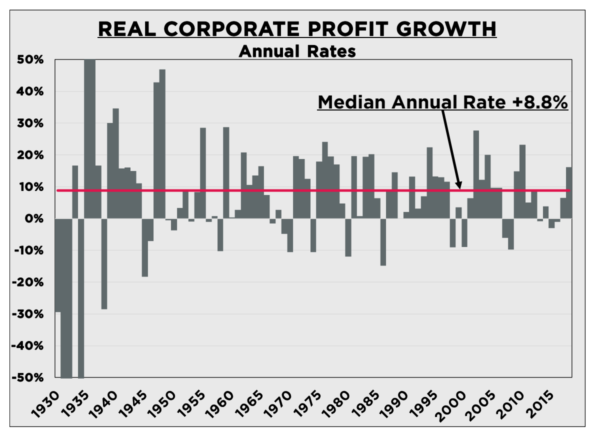

CHART III