EXPECT THE UNEXPECTED

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If you told me in March that in less than 100 trading days, the S&P 500® Index would be back near all-time highs, I would not have believed you. 2020 is teaching investors a lesson that should be apparent to all of us who watch the market closely: it is full of surprises. The best way to plan for surprises is to be ready for a wide range of outcomes. For example, when thinking about what stocks are going to do over the next 10 years, there are four destinations, with an unlimited set of paths.

- Maybe we get lower returns, as many—myself included—are expecting.
- Maybe we get historical average returns.
- Maybe we get the worst returns we've ever seen.
- Or maybe the next decade looks like the last and we continue to see above-average returns.

We should be prepared for surprises, but we shouldn't let them guide us.

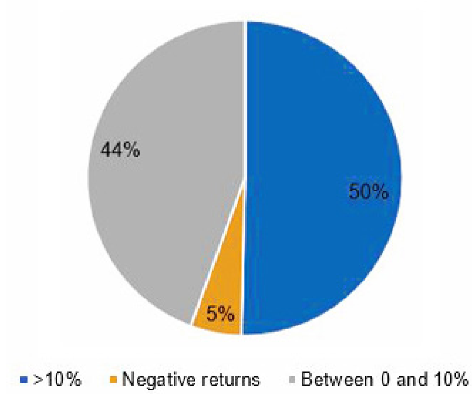
When thinking through what the future might look like, it's helpful to look at the past. The worst returns we've ever seen are possible, but are they likely? And based on what? And how bad can it get?

95% of the time, stocks delivered a positive nominal return, and the worst 10-year period ever saw stocks fall 5% a year. But be careful of taking these numbers too literally, because history only shows us what has happened, not what can happen.

Prior to this year, you would have concluded that the likelihood of the stock market falling 30% in five weeks was zero. It never happened until it happened.

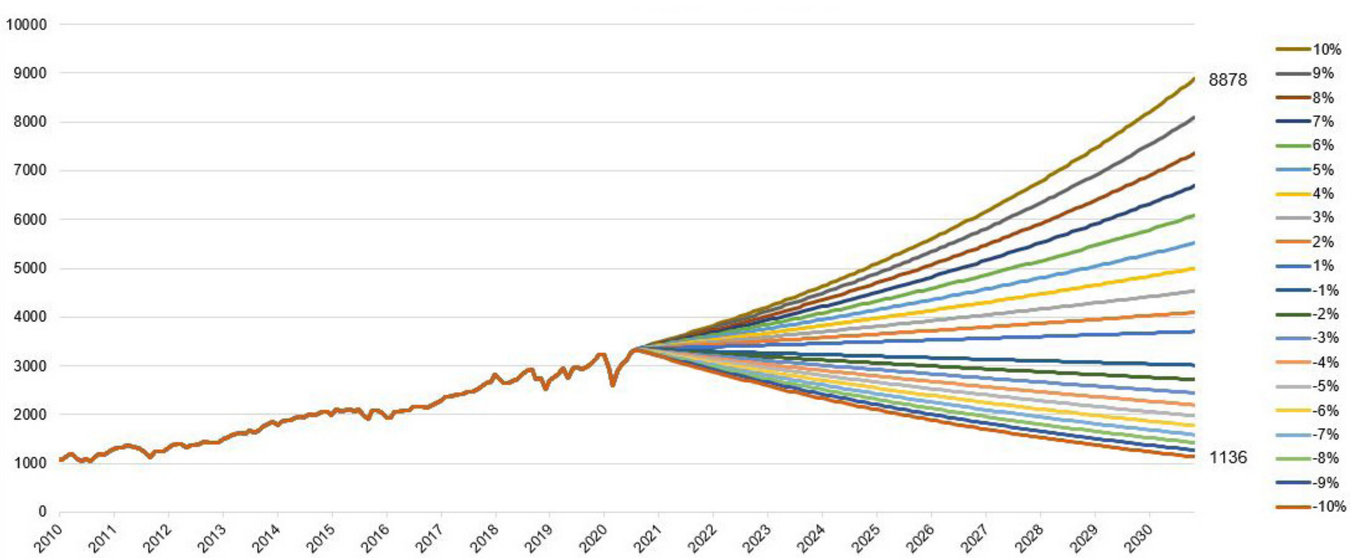
The chart below shows a wide range of outcomes over the next 10 years, assuming the market does between -10% and +10% annually for the next 10 years.

S&P 500® INDEX—10-YEAR ANNUALIZED TOTAL RETURNS



Past performance is not indicative of future results.
Source: Returns 2.0.

S&P 500® INDEX



Past performance is not indicative of future results. Data Source: YCharts. Author's calculations.

Stocks have never lost more than 5% a year for 10 years, so some of the lower lines might look completely ridiculous. Okay, and what word would you use to describe a year where the economy closes for four months and the stock market is positive?

Good investing is about preparing for base rates *and* being able to live with surprises. Easy to write, hard to do.

I'll give the last words to Morgan Housel:[1]

History is mostly the study of surprising events. But it is often used by investors and economists as an unassailable guide to the future. Do you see the irony? Do you see the problem?

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[1]Excerpted from *The Psychology of Money: Timeless Lessons on Wealth, Greed, and Happiness,* 2020.

The **S&P 500® Index** is a free-float market-capitalization weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and it is not available for direct investment.