

## Lessons from an Investing Time Machine

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Time travel is every investor's fantasy – imagine if you could go back forty years and make investment decisions, knowing then what you know now.

That's precisely the opportunity I gave a group of investors one recent evening.



That morning, I had received a panicked call from a financial advisor I know quite well, who is based in my home market of Toronto. This advisor had just got off the phone with a high-profile economist who was scheduled to do a presentation to 200 of his clients that night. The economist had called to say that he had a family emergency and he wouldn't be able to deliver this talk – and the advisor was inquiring to see if I might be able to fill in on short notice.

When I asked this advisor what he wanted me to talk about, the answer was that he didn't care – all he wanted was someone on the stage other than him.

That night, I stood up in front of the assembled audience, who politely hid their disappointment at the bait and switch tactic of having shown up to hear a celebrity economist and getting me instead.

I asked them to imagine that it was January 1 of 1970, forty years ago – and they had \$100 to invest. They could put that \$100 in one of six stock markets: the United States, Europe, Japan, Hong Kong, Canada and Australia. Further, they could divide it up in any way they wished – they could put it all into one market, divide it up evenly among the six or any combination in between.

### **An exercise in time travel**

In essence, the people in the room had a chance to go back in time forty years.



I gave the audience a few minutes to decide on their allocation – and then we talked about where they'd placed their bets. Given the statistics on home market bias and Canada's recent performance, predictably Canada was the most popular choice. Its proximity and size made the US a favorite as well, with some investors putting money into Hong Kong and Australia. Almost no one put much of their \$100 into Europe or Japan.

As an aside, the reason I chose 1970 as a starting point is that's when global market data began to be gathered by MSCI, the industry standard for tracking investment returns. There is good U.S. market data going back to the early 1920s, but for most of the rest of the world, forty years is as far back as reliable data exists.

### **And the answer is ....**

I then shared the outcome of that \$100 investment in each market, all in U.S. dollars for the sake of consistency.

Hong Kong finished a distant first, with no other stock market in sight. Then came Europe followed by commodity driven Canada and Australia. Trailing the pack were Japan and ... in last place ... the United States.

Here's how that \$100 tracked in value over the past forty years:

<b>Jan 1</b>	<b>1970</b>	<b>1980</b>	<b>1990</b>	<b>2000</b>	<b>2010</b>
<b>Hong Kong</b>	\$100	\$933	\$3,386	\$21,832	\$33,512
<b>Europe</b>	\$100	\$228	\$1,241	\$4,805	\$6,116
<b>Canada</b>	\$100	\$285	\$859	\$2,195	\$5,285
<b>Australia</b>	\$100	\$151	\$553	\$1,259	\$4,185
<b>Japan</b>	\$100	\$496	\$6,167	\$5,754	\$4,011
<b>US</b>	\$100	\$157	\$763	\$4,347	\$3,818

### **Six observations**

This exercise prompted lots of conversation – I shared six observations with the audience.

#### ***1. The perils of just looking at the numbers***

Looking at points in time often masks big market swings and lots of volatility along the way.



When they saw the numbers, many of the audience indicated they'd changed their minds and said they'd increase their allocation to Hong Kong – until I showed them a chart of the incredible roller coaster ride that investing in Hong Kong has been, with 50% moves up and down common. I asked them to think hard about whether they would have had the stomach for that ride.

## ***2. Be aware of the recency effect***

This is a phrase academics who study investor behavior use to describe our tendency to place greater weight on more recent events. Japan has done incredibly miserably over the past twenty years and so got an almost zero allocation – because members of the audience had forgotten the eighties when the Japanese stock market was the eighth wonder of the world, multiplying fourteen times over a ten year period.

## ***3. Extrapolating hot markets***

Just because a stock market has done well in one period doesn't mean it will outperform in the next.

The United States is an excellent example.

In the twenty years from 1980 to 2000, the American market was the top performing market with an amazing annual return of 18%, increasing 28 times over and even ahead of Hong Kong. By contrast, Canada and Australia had an average annual return of 11%, multiplying 8 times over in those 20 years.

Looking at this, you see the impact of the commodity exposure in Canada and Australia, but you also see the difficulty in extrapolating from a ten- or even twenty-year period to the next.

## ***4. Understanding the impact of currency rates***

If you have a short- or even mid-term timeframe, you need to be conscious of the effect of currency swings when investing globally.

One reason for the weak performance of the U.S. market compared to the rest of the world in the last ten years was the weak dollar. In fact, when you look at the European market in US dollars over the past ten years, all of the gain has come from currency appreciation vs. the US.

Even over longer periods, currency can have a big impact on both volatility and returns. In local currency, over forty years Europe's index grew from 100 to 4,770, still well ahead of the United States, but with a much narrower gap than



when looked at in US dollars – simply because the US dollar was at an elevated level in 1970.

As an illustration of currency effect, here's how the European stock market performance looks in both local European currency and U.S. dollar terms:

Jan 1	European currency	US Dollar
1970	100	100
1980	163	228
1990	1,093	1,241
2000	4,768	4,805
2010	4,770	6,116

### ***5. Pause a moment before jumping to conclusions about the “lost decade” for investors***

There's been lots of commentary about the fact that the ten year period from 2000 to the end of 2009 was a lost decade for investors – and moreover the worst decade on record.

That's absolutely true if you're just looking at the United States.

The fact is, however, that while returns may not have been sterling, over the past ten years investors have seen gains in most markets outside the U.S. market. While the U.S. market is still dominant, even after its miserable performance over the past ten years, it only represents about half of the global market capitalization – there's still the other 50% to take into account.

### ***6. Look before you leap***

Finally, check the facts before acting on stereotypes.

When you talk about investing in Europe, most Americans instinctively think of militant unions, stodgy bureaucrats, ossified companies and interventionist, sclerotic governments – and yet over the past forty years investors in Europe have done substantially better than those in the United States.

Even more extraordinary, of the “*big three*” euro countries – France, Germany and the United Kingdom – over the past forty years France turned in the best stock market performance and Germany the worst, exactly the reverse order that most investors and advisors would have guessed.

My most important conclusion?



It's fine to have impressions and opinions – just be sure to check the facts before acting on those opinions. Unless you do that, even going back in time won't improve your investment performance.

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