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In the Markets Now

Market falls, earnings grow

We believe in the old saying: a picture is worth a thousand words. Here, we aim to recap recent market action and provide some perspective to investors.

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May 2022

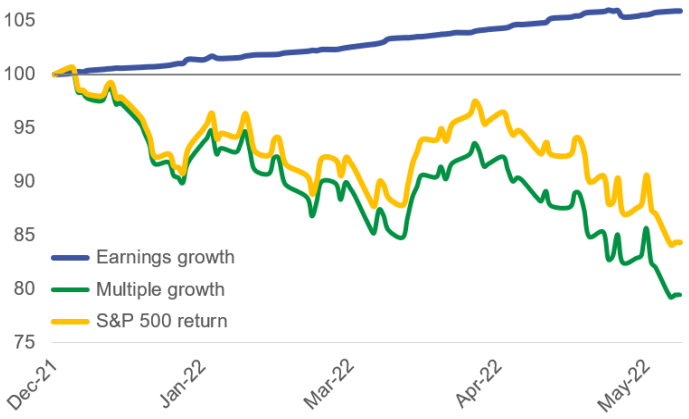
DIGGING INTO THE MARKET SELLOFF

Since 1928, the stock market has returned, on average, about 10% per year. Since 1928, the stock market has also seen 14 recessions, 18 bear markets, and 50+ corrections. **Fairly regular market weakness (and the occasional crash) is a fundamental part of the long-term investor's experience—and has been for hundreds of years.** Viewing things through that lens, this current bout of weakness was inevitable; the only question was what would eventually bring it to a head.

Heightened market volatility and big price swings also tend to obscure the reason for investing in the first place. Stocks go up over the long-run because they are shares of ownership in companies that grow their earnings. It's that simple. Earnings don't go up in a straight line, just as stock prices don't, but as companies have innovated and the economy has expanded, they have grown substantially—and the market has followed suit.

Per Ben Carlson, "In 1928, earnings per share for the S&P 500 was $1.11 while corporations paid out $0.78 per share in dividends. It was impossible to do so at the time, but if you could have owned an index fund, those would have been your per share cash flows. By the end of 2021, those numbers were $197.87 and $60.40, respectively. This means over the past 94 years, earnings on the U.S. stock market have grown at an annual rate of 6% while dividends have grown 5% per year."

Earnings growth not responsible for recent weakness



In essence, the stock market has gone up over time because earnings have gone up over time. But at any given moment, the level of the stock market reflects both the earnings of US companies *and* the price investors are willing to pay for them. This is where market volatility often comes from. In some environments, investors will pay more for the same share of earnings than they would in another environment (e.g. low interest rate vs. high interest rate). **Today, stock prices are plummeting, but earnings are actually growing and projected to continue to do so.** To use some industry jargon, the entire selloff (to date) is just "multiple contraction" —investors are rethinking what they are willing to pay for a share of the market as interest rates rise. This could change if the economy sours and earnings plateau, but for now, that's not the case.

No selloff is fun, but in my opinion this is healthy—a re-examnation of market valuation while the underlying fundamentals remain mostly solid. An investor once quipped: "The stock market is the only market where things go on sale and all the customers run out of the store." In this case, the quote couldn't be more true. Earnings haven't fallen, but the price to buy them has.

Of course, given a long enough time horizon, every selloff should look like a sale. The stock market has not been down over a single rolling 15-year period since 1926. **Buying the dip isn't always immediately rewarded and it can be painful during that waiting period, but over the past 90+ years every drop has proven a buying opportunity.** Build a financial plan, play the long-term game, and the day-to-day volatility is just noise.

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