Long-term perspectives

Stock market: Improving probability with age

Wealth Management
Dominion Securities

Lengthening the investment timeframe can help favourably shift the probability of realizing positive outcomes in equity markets. When volatility ramps up, it is important to keep in mind that the likelihood of positive outcomes for equity markets typically gets better with time.

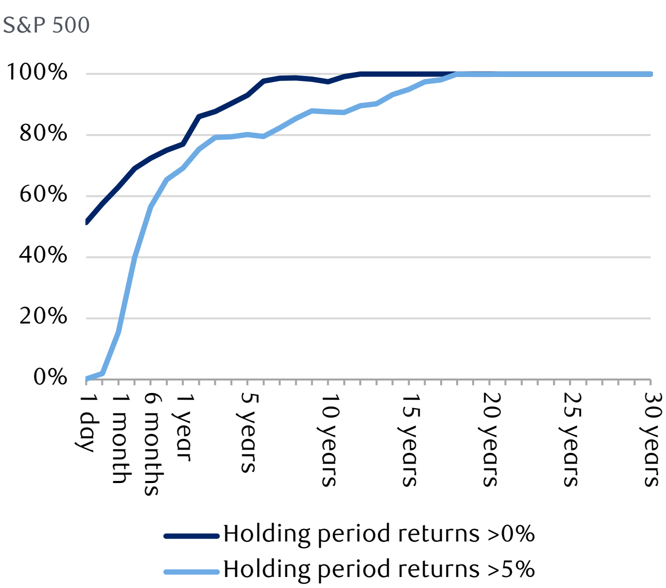
Volatility is the norm

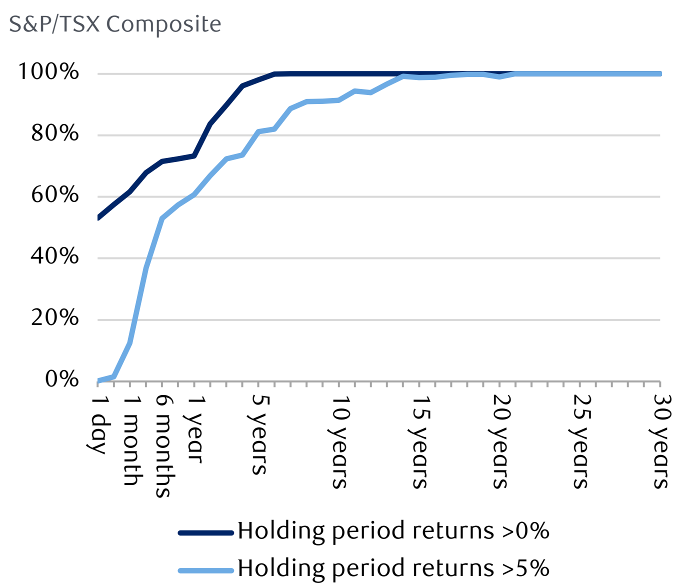
Equity markets are known for their unpredictability over shorter time periods. While market gyrations always seem to emerge randomly, corrections are an inherent part of investing in stocks. Since 1928, the S&P 500 Index has experienced, on average, roughly three corrections of at least 5% per year, one of at least 10% per year, and a bear market where prices fall more than 20% every 3–4 years. Despite this recurring volatility, however, the S&P 500 has generated positive annual total returns roughly 75% of the time over the past 95 years.

Time as an effective antidote

One of the most useful tools investors have at their disposal for handling fitful price swings is time. Extending the investment timeframe can help influence the probability of realizing more favourable outcomes. For investors, a key principle should be to think in terms of probabilities. The charts below illustrate the prospect of earning positive returns and annualized returns greater than 5%, depending on the length of time invested. The curve is particularly steep at the start. The probability of earning a positive return on any given trading day or week is no better than a coin flip. As the holding period increases, the likelihood of a positive outcome rises

Historical probability of positive returns based on rolling holding periods





Source - RBC Wealth Management, Bloomberg; data through 12/31/23. Periods one month or longer based on monthly data, periods over one year based on annualized returns.

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significantly to about 70% for one-year rolling time periods, 80% for three-year rolling periods, 90% for five-year rolling periods, and approaches 100% for rolling periods longer than five years.

Stocks require patience

Equity markets can get choppy in the short term and this volatility is always uncomfortable. During these times, we believe it is crucial to exercise discipline. Resisting the impulse to react to transitory market noise is important because stocks tend to rise over the long run. In the stock market, time horizon is a valuable edge that investors can seek to exploit. The longer the capital is invested, the more time there is for total returns to compound and the better the likelihood of earning a required return.

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