How Do the Markets Really Work?

We all do it. But what do we really know about investing? A recent post about investing wisdom features a lot of interesting (and often overlooked) facts and figures, plus some insights from Warren Buffett, Jeremy Siegel, William Bernstein, Nobel laureate Daniel Kahneman and a few economists you may have heard of.

Regarding market predictions, the post had this to say:

The phrase "double-dip recession" was mentioned 10.8 million times in 2010 and 2011, according to Google. It never came. There were virtually no mentions of "financial collapse" in 2006 and 2007. It did come. A similar story can be told virtually every year.

According to Bloomberg, the 50 stocks in the S&P 500 that Wall Street rated the lowest at the end of 2011 outperformed the overall index by 7 percentage points over the following year.

Many of the items offered insight into how our investment markets actually work. For instance:

Since 1871, the market has spent 40% of all years either rising or falling more than 20%. Roaring booms and crushing busts are perfectly normal.

Apple increased more than 6,000% from 2002 to 2012, but declined on 48% of all trading days during that time period. (Investing is never a straight path up.)

Polls show Americans for the last 25 years have said the economy is in a state of decline. Pessimism in the face of advancement is the norm.

A broad index of U.S. stocks increased 2,000-fold between 1928 and 2013, but lost at least 20% of its value 20 times during that period. People would be less scared of volatility if they knew how common it was.

There were 272 automobile companies in 1909. Through consolidation and failure, three emerged on top, two of which went bankrupt. Spotting a promising trend and identifying a winning investment are two different things.

According to economist Tim Duy, "As long as people have babies, as long as capital depreciates, technology evolves, and tastes and preferences change, there is a powerful underlying impetus for growth that is almost certain to reveal itself in any reasonably well-managed economy."

The post had a few zingers about some of the best-paid executives in the financial and investment community:

Twenty-five hedge fund managers took home $21.2 billion in 2013 for delivering an average performance of 9.1%, versus the 32.4% you could have made in an index fund. Hedge funds are a great business to work in -- not so much to invest in.

In 1989, the CEOs of the seven largest U.S. banks earned an average of 100 times what a typical household made. By 2007, that had risen to more than 500 times. By 2008, several of those banks no longer existed.

And finally, if you want to understand the difference between daily fluctuation and the underlying growth of value in the markets, consider this:

Investor Ralph Wagoner once explained how markets work, recalled by Bill Bernstein: "He likens the market to an excitable dog on a very long leash in New York City, darting randomly in every direction. The dog's owner is walking from Columbus Circle, through Central Park, to the Metropolitan Museum. At any one moment, there is no predicting which way the pooch will lurch. But in the long run, you know he's heading northeast at an average speed of three miles per hour. What is astonishing is that almost all of the market players, big and small, seem to have their eye on the dog, and not the owner."

Source:

<http://www.businessinsider.com/things-everyone-should-know-about-investing-and-the-economy-2014-12>