Inflation, not temporary volatility, is the true enemy

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My first "investment" was in a savings account at a local bank. I remember that I was taught to track the interest in the passbook so that I could watch the funds grow, albeit very, very slowly. The main reason that savings and checking accounts don't pay much interest is due to their inherent "safety". Sure, banks can go out of business, but the assets in most savings and checking accounts is insured, and thus the chance of principal loss is very close to zero. However, with such low rates of return, the loss of purchasing power is almost guaranteed. Since the chance of principal loss is essentially nonexistent, there is no risk premium, and thus the rate of return, especially after figuring inflation, is very low.

Stretching out a bit farther are CD's, which also tend to be insured from principal loss. However, CDs tend to provide some level of illiquidity where you cannot access the funds for 3-months, 6-months, a year or more. This added level of risk results in CD's yields being higher than a typical bank savings account, but not by much.

I mention the above as publicly traded businesses (stocks/equities) can certainly be subject to a fair amount of volatility, especially in the shorter-term as we have witnessed recently. While these sometimes dramatic fluctuations can be quite scary, it is precisely these fluctuations that have resulted in publicly traded businesses historically providing rates of return well in excess of inflation, which has averaged 3% for the past couple of hundred years. The only sure way to capture the full permanent return of equities is to be willing to capture the periodic temporary declines.

The recent volatility in the capital markets is not fun to watch and can certainly feel scary. It is hard to watch the value of your hard-earned assets fluctuating dramatically. But it is precisely these shorter-term fluctuations, this added layer of shorter-term risk, that has resulted in publicly traded businesses being such great ways to produce and grow wealth over time. If these investments did not suffer these types of temporary fluctuations, then the long-term rate of return would be similar to that from a checking or savings account. While the perceived safety from cash can help one to sleep at night, over-time the loss of purchasing power from these "safer" holdings almost guarantees significant problems in the future.

Time remains the volatility killer. Over the shorter-term just about anything can happen. But over longer periods of time, say 10-years, 15-years or longer, the probability of suffering a loss in publicly traded equities drops to essentially zero. Thus, the risk is not of publicly traded businesses providing a below average rate of return, but optimizing our behavior so that we do not react at the wrong time. In this way we can make sure that your assets are able to help you lead a comfortable and financially independent lifestyle whether you have just a few years or many decades to look forward to.

While these temporary periods of higher volatility are never much fun to experience, it is the cost for generating longer-term, attractive rates of return. As well as helping you to maintain your purchasing power and avoid losing ground to inflation. Part of my role is to help make sure that you are as comfortable as possible as we get through these temporary negative periods. Certainly, if you have questions, concerns or I can help in any way, please do not hesitate to let me know.

All my best,

Bryan