2014 the Big Picture™

Conversation Guide

for Financial Professionals

How to use the Big Picture™ chart to

grow assets under management and

keep clients invested

Why use the Big Picture chart?

Financial advisors today face a challenging investing public. Some clients are too focused on the near past. Some insist on trying to time the market. Others are new to investing, and would benefit from an illustrated introduction to its main principles.

Through its elegant design and 88-year breadth, the Big Picture chart can help you convincingly address each of these audiences.

How to use the Big Picture chart:

Top Four Conversation Topics

Risk, return, and diversification

Domestic stocks

The chart shows that domestic stocks have vastly outperformed every other asset class, compounding at 9.9 percent from 1926 through 2013. Behind this spectacular return, however, has been an equally important element of risk (as measured by volatility). This is expressed numerically in the chart's summary table, and visually in the variability of the plotted line for this asset class.

Additionally, the "Bull & Bear Markets in U.S. Stocks" graph shows that stocks have experienced eight declines of over 20 percent in the past 88 years. Some declines, like those in the early 30s and 2000s, were prolonged. At other times, the market promptly recovered and went on to reach new highs.

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International stocks

International equities have delivered a long-term annual return of 8.2 percent — 1.7 percentage points lower than their U.S. counterparts. But there have been extended periods when international stocks have outperformed other major asset classes — as, for example, in the 50s, 70s, and 80s. Foreign equities have historically been riskier than domestic equities, in part due to currency fluctuations.

Bonds and T-Bills

On average, government bonds have compounded at a relatively unhurried 5.3 percent per year. But bonds have been less than half as volatile as stocks, with an all-bond portfolio experiencing only the occasional dip in value. T-Bills, meanwhile, have delivered a 3.9 percent annualized return. While T-bill returns have been the lowest of major asset classes, they have been the steadiest.

Balanced, income and growth portfolios

A hypothetical balanced portfolio consisting of ten percent T-Bills, 35 percent bonds, and 55 percent domestic stocks has landed in the middle of the risk-return spectrum. The portfolio's returns have averaged a respectable 8.3 percent, at just over half the risk of domestic equities. And when stocks have fallen, the balanced portfolio has always fallen less.

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A hypothetical income-oriented portfolio, heavily weighted toward fixed income investments, has offered a relatively conservative risk-return profile. A growth-oriented portfolio, heavily weighted in equities, has delivered a higher long-term return — but at higher risk.

2 Inflation: A constant risk

As the Big Picture chart shows, one dollar today is worth only one-thirteenth what it was in 1926. Investors need protection from inflation, and the best asset class for the job has historically been stocks. Over the past 88 years, domestic equities have cumulatively outgrown inflation by a factor of 315.

Some of today's volatility-averse investors have flocked to the relative safety of T-Bills and other low-risk instruments. But a glance at the Big Picture chart shows that T-Bills have barely outpaced inflation. Use the chart to explain that peace of mind may come at the price of long-term purchasing power.

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3 The importance of staying invested

As the Big Picture chart shows, one thousand dollars invested in U.S. stocks in 1926 had grown to $4,096,849 by the end of last year. How could anyone have lost money over this period? Plenty of folks did, by "dancing in and out of the market", to quote Warren Buffett.

Flighty investor behavior is damaging to returns — and to your business. Use the Big Picture chart to launch a two-pronged argument against such impulses. First, remind market-timing clients that the future cannot be reliably foretold, no matter how authoritative the foreteller. Note the following captions in the Big Picture chart: One, which quotes Alan Greenspan as "unqualifiedly bullish" in January of 1973, just prior to a 40 percent market crash, and another, which marks the 1979 publication of Business Week's "Death of Equities" issue, right before the market's greatest bull run ever.

> "In all but one of the past 15 recessions equities rallied — sometimes dramatically — before the recession ended.

Second, point out that stocks have surged when people have least expected them to, leaving behind those on the sidelines. Use the chart to show that in all but one of the past 15 recessions equities rallied — sometimes dramatically — before the recession ended.

The Time & Risk chart, which shows that the longer the holding period, the lower the historical likelihood of loss, also speaks to the importance of staying invested. For example, the chart shows that a $100 investment in the balanced portfolio made at the beginning of the worst 1-year period would have delivered an annual return of negative 43 percent. The same investment made at the beginning of the worst 5-year period would have delivered an annual return of just negative 8 percent. Meanwhile, the same investment made at the beginning of the best 5-year period would have yielded a 24 percent compound annual return.

> "Buying and holding the balanced portfolio over any 1-year period has produced a positive return 79% of the time. Over any 5-year period it has produced a positive return 94% of the time.

An investor holding the balanced portfolio for just one year has made money 79 percent of the time since 1926. Buying and holding the balanced portfolio for any 5-year period has produced a positive return 94 percent of the time.

And here's perhaps the most powerful argument for staying the course: Over the past 88 years, an initial investment in U.S. stocks has grown 4,097-fold despite multiple wars, 15 recessions, periods of rampant inflation, double-digit interest rates, and several world crises.

Continued on reverse

4 Price-to-earnings as a means to set expectations

"When confidence is low, market valuations are likely to be attractive." Vanguard's John Bogle calls this the "Paradox of Investing". The Big Picture chart bears out both his conclusion and its inverse: when confidence is high, market valuations are likely to be unattractive.

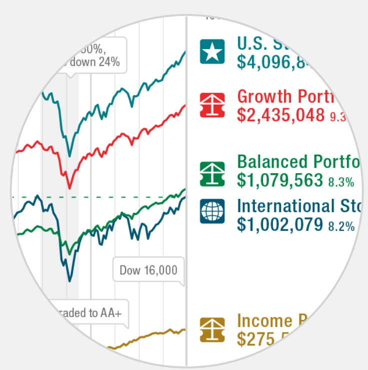
Over time, corporate earnings have grown in line with the overall economy and advances in productivity. This underlying growth has been fairly steady over any reasonably long investment period. Yet the history of stock prices shows a wildly alternating pattern of exuberance and depression concerning the economy's prospects.

A quick look at the S&P 500 Price-to-Earnings graph in the Big Picture chart reveals that periods of weak confidence, as measured by the market's overall PE, have consistently been followed by above-average returns, and vice versa. In 1929, the price assigned to stocks was more than 35 times trailing earnings. Their ensuing ten-year annualized return was -4.1 percent. In 1982, the PE ratio had fallen below seven. The next ten years went on to deliver an astounding 18.5 percent compound annual return. And so on throughout history. It boils down to a simple but frequently overlooked law of investing: it's not just the pace of earnings growth that dictates one's return, it's how much one paid for that growth.

Far from an endorsement of market timing, this chart feature provides added context and helps establish realistic return expectations.

Other conversations

In addition to the topics above, the Big Picture chart is appropriate for discussions about trends in oil, gold, and real estate. The chart also displays interest and inflation rates, and dozens of key historical events.



This chart shows the inferred growth of one thousand dollars invested on January 1, 1926. This chart is for illustrative purposes only; it does not constitute investment advice and must not be relied on as such. Assumes reinvestment of all income and no transaction costs or taxes.

The portfolios shown are neither real, nor recommended. They were rebalanced each January. Risk is measured by the standard deviation (volatility) of annual returns. All returns are compound annual returns unless otherwise indicated. An investment cannot be made directly in an index. Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than the other asset classes shown. International stocks involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

Sources: U.S. Stocks: S&P 500 Total Return index, U.S. Small Cap Stocks: NYSE/NYSEMkt,NASDAQ Small Cap Index, Treasury Bills: CRSP 90-Day T-Bill Returns—Center for Research in Security Prices (CRSP). International Stocks: ex-U.S.A. Total Return Index, Bonds: USA 10-year Government Bond Total Return Index, exchange rates—Global Financial Data, Inc. Inflation: Consumer Price Index—U.S. Bureau of Labor Statistics. Prime Interest Rate—The Federal Reserve. House Price Index—Shiller, R. Recessions—National Bureau of Economic Research. S&P 500 Price-to-Earnings Ratio; S&P 500 Dividend Yield—Shiller, R. Gold prices—Kitco. Oil prices—Inflationdata.com.

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