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The Four Most Dangerous Words in Investing

Legendary investor Sir John Templeton once said, "The four most dangerous words in investing are: This time is different."

Those words are especially relevant today.

Many investors believe today's market concentration is justified because artificial intelligence will permanently reshape the economy. Perhaps they're right. AI may prove to be every bit as transformative as many expect.

But history teaches an important lesson: even when a technological revolution is real, investors can still overpay for it.

The investors who bought radio and aviation stocks in the 1920s, the Nifty Fifty in the 1960s, or internet stocks in the late 1990s were not necessarily wrong about the future. They were often wrong about the price they paid.

Today, some of the same conditions that preceded previous "lost decades" in the stock market are once again present.

The issue isn't whether AI, the current transformative technology, will change the world. It's whether today's stock market has already overpriced reasonable expectations.

Understanding a "Lost Decade"

A lost decade is an extended period, typically ten years or more, during which stock market returns are very low or even negative after accounting for inflation.

The United States has experienced several such periods over the last century, including:

- **1929–1954**
- **1966–1982**
- **2000–2009**

All three of these lost decades are clearly visible on the interactive chart found here:

www.macrotrends.net/1319/dow-jones-100-year-historical-chart

Sir John Templeton

While every period was different, they shared several common characteristics. Two of the most notable were elevated valuations and extreme market concentration. We have discussed valuation concerns in previous Macro Memos. Today, we want to focus on concentration.

The Hidden Risk in the S&P 500

One hallmark of many market bubbles is that an increasingly small group of stocks drives a growing share of overall market returns.

In the 1920s, investors became captivated by radio and aviation companies. In the late 1960s and early 1970s, enthusiasm centered around the *"Nifty Fifty."* The Nifty-Fifty stocks were a group of wildly popular large-cap stocks in that era. They were considered the bluest of "Blue Chip" and included names like Xerox, IBM, Pitney Bowes, Eastman Kodak, and Polaroid.

During the late 1990s, internet stocks dominated investor attention.

Today, market concentration is centered on large technology companies competing in the artificial intelligence race.

The ten largest companies in the S&P 500 now account for approximately 40% of the index's total market value. Eight of those ten companies are heavily involved in artificial intelligence.

Put differently, for every $100 invested in an S&P 500 index fund, roughly $40 is allocated to just ten companies.

Many investors believe they own a highly diversified portfolio because they own an index fund. Increasingly, they may own a concentrated bet on a handful of technology companies.

This concentration does not guarantee poor future returns. However, history suggests it is a risk worth understanding.

When Market Leaders Become Market Laggards

Market leadership can change dramatically over time.

The following companies were among the most admired and widely owned investments of their eras (see chart below):

Several lessons emerge from these examples:

1. Today's market darlings can become tomorrow's disappointments.
2. Price matters. A great company is not always a great investment if purchased at the wrong price.
3. Passive index investing does not eliminate concentration risk.

Why This Matters More for Retirees

For younger investors, a significant market decline can be frustrating. For retirees, it can be far more consequential.

This is where something called "sequence of returns risk" becomes important.

Sequence risk occurs when poor market performance happens early in retirement while withdrawals are being made from a portfolio. Those withdrawals lock in losses, leaving less capital available to participate in future recoveries.

Even if long-term average returns ultimately prove satisfactory, the order in which those returns occur can have a significant impact on retirement outcomes.

Two retirees could earn the same average return over twenty years and experience dramatically different results simply because one experienced losses early while the other experienced them later.

This is why the first decade of retirement is often the most important.

Company	Year	Starting Value	Ten Years Later
United Aircraft & Transport	1929	$100,000	$15,000
RCA	1929	$100,000	$4,000
Xerox	1969	$100,000	$70,000
Polaroid	1969	$100,000	$24,000
Microsoft	1999	$100,000	$36,500
Amazon	1999	$100,000	$118,500[1]

[1] While Amazon generated a positive nominal return over the ensuing 10-year period, it trailed inflation and therefore, had a negative real return for the period.

Source: CRSP US Stock Database (University of Chicago Booth School of Business); returns calculated using split-adjusted prices, excluding dividends unless otherwise noted.

Avoiding major losses can be just as crucial as capturing gains, and arguably even more so.

Diversification Changes the Story

A lost decade does not mean every investment performs poorly.

While large-cap U.S. stocks struggled during previous lost decades, other asset classes often generated attractive returns.

The 1970s provide a useful example. U.S. stocks and bonds both produced negative inflation-adjusted returns during the decade. Commodities, however, generated strong real returns and helped preserve purchasing power for investors who owned them.

Different environments reward different assets. This is why we focus on diversification across truly distinct sources of return, not simply different categories of U.S. stocks and bonds.

International equities, real assets, commodities, and other low-correlated investments can help reduce dependence on a single market outcome.

Diversification cannot eliminate risk, but it can help reduce the impact of any one asset class experiencing a prolonged period of disappointing returns.

Conclusion

History rarely repeats exactly, but it often rhymes.

We are not necessarily predicting a lost decade, but we are recognizing that some of the same conditions that preceded previous lost decades, high valuations, extreme concentration, and widespread investor enthusiasm, are present today.

For younger investors, a market decline may create opportunities to accumulate assets at more attractive prices. For retirees and those nearing retirement, however, the consequences can be more significant because sequence of returns risk leaves less time to recover.

That is why portfolio construction matters.
The goal is to build a portfolio capable of navigating a range of possible futures.

If you would like to discuss whether your portfolio is positioned to support your retirement goals through a variety of market environments, we would welcome the conversation.

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