
All-Time-High Anxiety

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KEY TAKEAWAYS

- Financial journalists periodically stoke investors' record-high anxiety by suggesting the laws of physics apply to financial markets—that what goes up must come down.
- But shares are not heavy objects kept aloft through strenuous effort. They are perpetual claim tickets on companies' earnings and dividends.
- If stocks have a positive expected return, reaching record highs with some frequency is exactly the outcome we would expect.

Investors are often conflicted about record-high stock prices. They are pleased to see their existing equity holdings gain in value but apprehensive that higher prices somehow foreshadow a dramatic downturn in the future. And they may be reluctant to make new purchases since the traditional “buy low, sell high” mantra suggests committing funds to stocks at an all-time high is a surefire recipe for disappointment.

Financial journalists periodically stoke investors' record-high anxiety by suggesting the laws of physics apply to financial markets—that what goes up must come down. “Stocks Head Back to Earth,” read a headline in the *Wall Street Journal* in 2012.¹ “Weird Science: Wall Street Repeals Law of Gravity,” *Barron's* put it in 2017.² And a *Los Angeles Times* reporter had a similar take last year, noting that low interest rates have “helped stock and bond markets defy gravity.”³

Those who find such observations alarming will likely shy away from purchasing stocks at record highs. But shares are not heavy objects kept aloft through strenuous effort. They are perpetual claim tickets on companies' earnings and dividends. Thousands of business managers go to work every day seeking projects that appear to offer profitable returns on capital while providing goods and services people desire. Although some new ideas and the firms behind them end in failure, history offers abundant evidence that investors around the world can be rewarded for the capital they provide.

Whether at a new high or a new low, today's share price reflects investors' collective judgment of what tomorrow's earnings and dividends are likely to be—and those of all the tomorrows to come. And every day, stocks must be priced to deliver a positive expected return for the buyer. Otherwise, no trade would take place. It's difficult to imagine a scenario where investors freely invest in stocks with the expectation of losing money.

Investors should treat record high prices with neither excitement nor alarm, but rather indifference. If stocks have a positive expected return, reaching record highs with some frequency is exactly the outcome we would expect. Using month-end data over the 94-year period ending in 2020, the S&P 500 Index produced a new high in ending wealth in more than 30% of those monthly observations. Moreover, purchasing shares at all-time records has, on average, generated similar returns over subsequent one-, three-, and five-year periods to those of a strategy that purchases stocks following a sharp decline, as **Exhibit 1** shows.

Exhibit 1

All Rise

Average annualized returns for S&P 500 Index after market highs and declines

| | 1 year later | 3 years later | 5 years later |
|--------------------------|--------------|---------------|---------------|
| After new market high | 13.9% | 10.5% | 9.9% |
| After 20% market decline | 11.6% | 9.9% | 9.6% |

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Humans are conditioned to think that after the rise must come the fall, tempting us to fiddle with our portfolios. But the data suggest such signals only exist in our imagination and that our efforts to improve results will just as likely penalize them.

Investors should take comfort knowing that share prices are not fighting the forces of gravity when they move higher and have confidence that record highs only tell us the system is working just as we would expect—nothing more.

1. Jonathan Cheng and Christian Berthelsen, "Stocks Head Back to Earth," *Wall Street Journal*, February 11, 2012.
2. Kopin Tan, "Weird Science: Wall Street Repeals Law of Gravity," *Barron's*, August 7, 2017.
3. Russ Mitchell, "Tesla's Insane Stock Price Makes Sense in a Market Gone Mad," *Los Angeles Times*, July 22, 2020.

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