Holding Stocks for the Long-Term

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Another bear market in the wings? (A bear market occurs when one or more stock indices decline by more than 20%.) Here are some indicators of what is happening. After Target reported a shortfall in earnings, the stock plummeted 25% in one day. ARK Innovation, a hot growth stock mutual fund in 2020 with a gain of over 160%, gave that entire gain back. Bitcoin, the darling of the cryptocurrency crowd, fell below $30,000 bringing the decline from Bitcoin's peak to 55%! A tight Federal Reserve monetary policy plus a huge swelling in the government's fiscal surplus is taking liquidity out of financial markets. Government policies to curtail domestic oil and gas production is putting pressure on energy prices. All of this (and there's more) is sufficient bad news to send investors to the exits.

Long-term holders of quality common stocks have built up a large cushion against these declines because they participated in the bull market that began in 2009 that was only temporarily interrupted by the Covid selloff in early 2020. Individuals who claim to be long-term investors but who got on the train within the last year are at a disadvantage because they have started out with a sizeable loss in their portfolios. Unfortunately, this is the time that many of these investors get off the train, convert their stock portfolio into cash and sit on the sidelines with no idea of when or if they will ever invest in stocks again. Incidentally, when there is a visible increase in investors abandoning the stock market and holding cash, then, the end of the bear market is near.

Stock investments are unique because they are dynamic, you don't have to sell them to someone else at a higher price to make a profit. The idea is that a good stock investment will reward the investor with a stream of increasing dividends or be sufficiently attractive to be purchased by a larger company at a higher price. One long-term investor that had invested in a blue-chip stock many, many years ago benefitted from the company's dividend policy. For her, the dividend was higher than the price she originally paid for the stock! Another important attribute of long-term investing is that the short-term bumps and potholes in returns smooth out over time. The returns are also compounded usually resulting in larger increases in a portfolio's dollar value. If an investor rolls down a portfolio by selling stock and buying bonds, he or she loses out on the long-term compounding effect of being in a diversified stock portfolio.

Lastly, the importance of diversification cannot be underestimated. Individual stocks can have risky characteristics that are not easy for the average investor to identify. One such risk is "company" risk that results in losses if the company does not produce enough revenue or profits. This risk is prevalent among average investors who do not have the time to analyze individual company profit and loss statements. Often investors have an overly attractive outlook on a stock that the company fails to meet. Remember Enron that completely collapsed resulting in the loss of capital invested? In summary, investors should own a diversified portfolio of stocks of companies that are making money and profits and paying rising dividends over time. This strategy will likely produce long-term gains in portfolio values.