THE MOST POWERFUL FORCE IN THE UNIVERSE

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According to Albert Einstein, the most powerful force in the universe isn't nuclear fission, electromagnetism, or particle physics; it is compounding, the ability of things to grow exponentially. This phenomenon allows for something small to expand into something massive, even if growing very slowly.

A 10-inch plant growing at a barely noticeable 20% a year will be a 5-foot sapling in ten years, and in another ten years it will become a 31-ft tree.   All this without much help from anyone. Just leave it alone and let the power of compounding work its magic.

It is the genius of Warren Buffett that he applies the same principle to investing.   Find a good investment, let it compound and watch it grow. Buffett saw that what is needed to grow trees and investments is the ability to build on each period's growth with minimal trimming or waste. Early in his career he figured out that equities are the perfect vehicle for compounding money. Stocks are easy to buy, come in an almost limitless variety, grow at a compounded rate as the company grows, cost little to hold, actually pay you to hold them in dividends, are easy to sell, and are tax favored if you do.

Equities don't generally grow as fast as trees, but at 7.2% they will double in ten years and quadruple in twenty.   All you have to do is be patient, and not defeat your purpose by trading in and out of the market, or constantly moving your investments around. Each time you do that you trim off gains by paying taxes, and therefore reduce your period of compounding.

How badly does excessive trading effect performance?   A lot, because you lose most of the benefits of compounding. In fact, you would have to get a 12% annual return on a taxable account to get the same return over a ten-year period as a buy and hold investor gets on a modest 7% return. The math is compelling.   Still, billions of dollars pour into the hedge fund industry and other short-term trading schemes in search of illusive double-digit returns, when more conservative and better yielding long-term investments are readily available.

Maybe Einstein was wrong.   Maybe the most powerful force in the universe is blind greed.

STOCKS FOR THE LONG-RUN

Looking through portfolios we have managed for years, we are struck by some of the stocks that exemplify the power of long-term investing. We used the twelve year returns because that assumes that they were bought in 2007, the year before the crash of 2008. You had the worse timing imaginable and the returns have still been spectacular. As a reference, the overall market during that time was up about 210%, for a compounded annual rate of 6.4%. Still, not bad considering you invested just before the second biggest market crash in over a century.

NIKE had a twelve-year return of 628%, about three times the market. That is right! If you bought Nike twelve years ago and did nothing, a $10,000 investment would be worth $62,800, even if you pocketed the dividends along the way. That is thanks to Nike being a great company in a growing industry and the power of compounding. Its founder Phil Knight articulated the best marketing strategy I have ever heard when he said, "We are not in the shoe business; we are in the entertainment business." Phil took Nike from the slow growing shoe business to the fast-growing sport and casual clothing market, a trend that has lasted decades.

AMERICAN TOWER was founded by a radio station operator in Boston who rented out his radio tower to AT&T and then again to Sprint. Before long he was making more money on the cell tower than he was on the radio station, so he sold the radio station, but kept the tower and launched a brand-new business. Steve Dodge was a good manager in a growing market that has rewarded his investors with a 490% return during the past twelve years. He didn't invent anything new, nobody ever heard of him or his company outside the wireless industry, but he made his investors a fortune because he is a visionary in a growing market.

VISA is a company that everybody has heard of, but $10,000 of stock twelve years ago is worth an astonishing $141,000 today. Some of that is no doubt credited to good management, but when you are in a growing market, with only three major players, it's hard not to succeed. Although, for a while American Express did a pretty good job of trying to wreck a great thing. What Visa really had going for it was a worldwide trend of cash to plastic and the discipline to not stray from their core business.

KANSAS CITY SOUTHERN is the epitome of a boring investment. Railroads stopped adding track about a century ago, and between the unions and their exposure to cyclical freight, they are between a rock and a hard place. Except, they are growing, because trucks are less efficient, and they can cut costs with better technology. Fortunately for KSU their tracks lead in and out of Mexico. So, when the auto companies moved their plants there, KSU could supply them with parts and bring out the vehicles. That led to a 437% return, about double the S&P.

ADOBE is in anything but a boring business. It creates and moves digital documents, which makes it the backbone of all kinds of internet and cloud applications without having to take risks associated with most technology companies. Well there was some risk. The stock went down more than 50% in the crash of 2008, but if you held on, you were rewarded with a 767% return over the twelve years from 2007 through 2019.

What this diverse list of exceptional companies with great long-term returns all share is that they have good management, are in growing markets and don't stray from their core mission.

What's next? Crystal balls are hard to come by, but in addition to the above trends, which we don't see diminishing any time soon, here are a few more on our investment radar.

ELECTRIFICATION is trending again. A hundred years after Edison and Westinghouse revolutionized the lighting and small appliance world, the second revolution is underway to replace internal combustion with electric motors and the old power plants with renewable sources to be stored in super-efficient batteries.

THE AGING POPULATION is causing profound changes thanks to declining fertility and increasing life expectancy. The elderly population in the US is currently 16%, but it is projected to be 23% over the next 40 years. That's nothing compared to Japan at almost 30%, or Europe at 20-25%. Even China will have 30% of its population over 60 in 40 years. This will lead to slower growth, less inflation, and more emphasis on medical and recreational spending.

MORE EFFICIENT HEALTHCARE is not an option. It is a necessity if all of our GDP growth isn't going to be eaten up by medical costs. Hospitals have to give way to clinics, doctor's visits will have to be done by nurses and fragmented industries must merge as margins are squeezed.

GLOBALIZATION has gone way too far to stop now, despite the reactionary policy to slow it down with tariffs and attempts to block the free flow of information. Transportation and communication will grow faster than the economy as a whole. A company either produces a world class product, priced for the world market or it will not survive.

These are the big trends that as long-term investors we are using to buy stocks to secure our clients a fruitful retirement. Yes, there will be noise and market corrections along the way, but if we can find great companies riding the wave of important trends, we can compound money.

RETIREMENT ADVICE

Besides encouraging the power of compounding, we have helped hundreds of people enjoy a successful retirement and seen a few who failed. Here is what we learned.

DOWNSIZE, but do it carefully. Psychologists say moving is one of the most stressful things you can do, even if that means moving into your dream house on the 15th tee. Doing that in the same year you are trying to adjust to a new life as a retiree and working out your finances with no paycheck coming in is asking for a nervous breakdown. Do it slowly!

SIMPLIFY your life as much as possible.   Second and third homes, big boats, airplanes and anything else that takes maintenance and causes taxes should have a name on it, "For Sale".

REVIEW WILLS, TRUSTS, IRAS because retirement means big changes in everything from where you live to the balances in your retirement accounts. Your trusts and designation of beneficiaries need to be reviewed and then put everything in a safe place and tell the people who will be handling your estate where it is.   Call us, we'll tell you what you need to do.

DON'T TRUST OFF-THE-SHELF FIANCIAL PLANS because what they typically do is take your preretirement expenses and project them out forty years while projecting your investment return and tell you how much you will be worth when you're a hundred. Problem is nobody knows what the inflation rate or returns will really be, and nobody spends as much at 90 as they do when they're 60. Let us help you find a professional who can give you a real financial plan.

BE CONSERVATIVE BUT NOT FEARFUL in your investing.   You have no doubt heard the old adage that the percentage of your portfolio in bonds and other fixed income investments should be the same as your age, leaving a 70-year-old with 70% low returning investments. That paints a pretty grim picture for the next twenty or thirty years. Besides, if you have a portfolio with great long-term stocks, why not try to keep them for the grandkids, and cheat the tax man out of ever getting his hands on you, with a stepped-up cost basis on your death.

STAY ACTIVE AND MAKE NEW FRIENDS because soon you will be attending a lot more funerals than weddings, and you'll need to replace some.

BE PASSIONATE about something. If asked what you do now that you are retired, your answer should be: "I am having the time of my life doing…" If you can't do that, then the answer should be "I am looking for my new passion, got any ideas?"

Speaking of retirement, Bill Matthes is a young 72 and going strong while passing a lot of duties and ownership to Jason Bear. He hasn't found a new passion, and prefers the one he has, so no retirement is in sight. Instead, he gets to spend even more of his time looking for our next best investment idea and managing client portfolios.