Strategic View: Taking responsibility for market returns

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Over twenty years ago Charlie Ellis published the first edition of his investment classic, *Winning the Loser's Game*. His core message was simply to invest in markets, and resist trying to outsmart them. Stocks and bonds provide attractive returns to patient investors, so invest for the long run.

While Ellis' ideas have gained widespread popularity, they have also led to an unfortunate passivity among many owners of capital. In fact, the kind of exposure to a market index (such as the S&P 500) that Ellis promoted has become known as "passive" investing.

But should investing in the market be a passive exercise, and does it always lead to good outcomes? Market returns do not occur in a vacuum, but are the product of political, social, technological and economic trends that investors themselves help influence. A passive investor in German bonds would have lost 100% of their value during the hyperinflation of 1923, and a German equity investor would have lost 87% of value in 1948.[1] So just sitting back and watching your money grow does not work in all times and places. US markets in the first half of the 20th century endured two world wars, multiple financial panics, the Great Depression, the rise of communism and fascism, widespread labor discrimination, and the detonation of atomic bombs killing several hundred thousand human beings. The result was global investment returns less than half as good as what came after the War.

Our perception of long-term market outcomes is colored by the positive developments that emerged in the five decades following World War II: no global wars, a regulated and insured banking system, limited nuclear proliferation, the Marshall Plan, expansion of the middle class, improved social justice via the civil rights movement and related legislation, the EPA, the end of the Cold War, healthy economic growth with no depressions, and Federal Reserve economic management. The result was phenomenal market returns for 50 years in a variety of markets, with global stocks gaining 9% annually *in excess of inflation*.

Results like these are by no means guaranteed, and being a passive investor abdicates responsibility for the world that underpins economic and financial prosperity. The corporations that investors own now exert tremendous global power relative to government and labor. Investors can and should demand that companies desist in externalizing costs onto society and ignoring looming risks in the service of short-term gain.

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[1] All market return data from Dimson, Marsh and Staunton. Their book, *Triumph of the Optimists* (Princeton University Press, 2002), reviews 101 years of global investment returns.

It is encouraging that some investors and companies are taking a leadership role in analyzing critical long-term risks such as CO_2 emissions and biodiversity loss. Nothing will do more to secure market returns in this century than reversing global warming and limiting nuclear proliferation. It is all too easy to put issues like this into the box of "politics," disconnected from investment policy-making. But while investors can debate the appropriate course of action, there should be little disagreement that dire outcomes are possible and imminently material. When shareholder activism can reduce market risk, passivity is not the winning strategy.