

PERSPECTIVES

Why a Stock Peak Isn't a Cliff

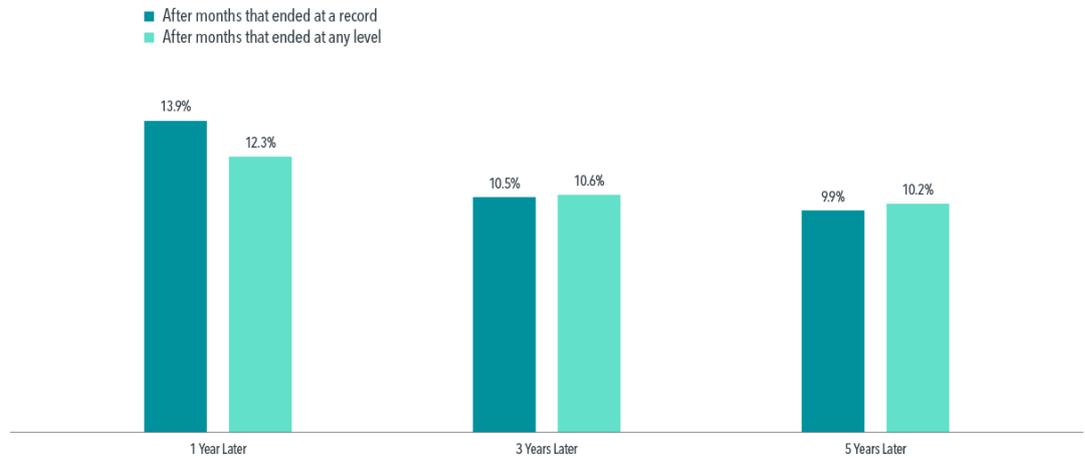
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Many investors may think a market high is a signal stocks are overvalued or have reached a ceiling. But they may be surprised to find out that the average returns for the S&P 500 Index one, three, and five years after a new market high are similar to the average returns for the index over any one-, three-, or five-year period.

In looking at all 1,000-plus monthly closing levels between 1926 and 2020 for the S&P 500 Index, 30% of the monthly observations were new market highs. After those highs, the average annualized compound returns ranged from nearly 14% one year later to just under 10% five years later. Those results were close to average returns over any given period of the same length. When viewed in terms of the index simply having risen or fallen, the S&P 500 was higher a year after notching a record 82% of the time, and 78% of the time after five years.

Exhibit 1S&P 500 Index Returns,
1926-2020

Average Annualized Compound Returns



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In US dollars. For illustrative purposes only. New market highs are defined as months ending with the market above all previous levels for the sample period. Annualized compound returns are computed for the relevant time periods subsequent to new market highs and averaged across all new market highs observations. There were 1,139 observation months in the sample. January 1926–December 1989: S&P 500 Index, Stocks, Bonds, Bills and Inflation Yearbook™, Ibbotson Associates, Chicago. January 1990–Present: S&P 500 Index (Total Return), S&P data © 2021 S&P Dow Jones Indices LLC, a division of S&P Global. All rights reserved.

History shows that reaching a new high doesn't mean the market will then retreat. In fact, stocks are priced to deliver a positive expected return for investors every day, so reaching record highs with some regularity is exactly the outcome one would expect.

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