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IN THE NEWS

"Fortune" Features David Booth Op-Ed on the Value of Uncertainty in Markets

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Dimensional Founder and Chairman David Booth recently contributed an op-ed to Fortune about the role uncertainty can play in investment success. Below is the op-ed in its entirety. Subscribers to Fortune can also read it here.

'UNCERTAINTY IS UNDERRATED': HERE'S THE REAL REASON MARKETS REWARD THOSE WHO STICK AROUND

By David Booth

Given all that is going on in the world, investors have questions. Will the Federal Reserve cut interest rates, and if so, by how much? Who will win the US presidential election, and will it impact markets? How will global events affect my family and finances? A lot remains uncertain, which can naturally make investors uneasy.

For many people, uncertainty is something to avoid or at least mitigate. People often talk more about the downside to uncertainty than its upside. There's even a term, loss aversion, that reflects how a loss can feel more painful than a gain of an equal amount can feel rewarding.

However, I have a different view: Uncertainty is underrated.

Without it, there would be no surprises, no joy in watching sports, and no 10% average annualized return on the stock market over the past century.[1]

All investments involve risk—there is no guarantee of success. Investors can be rewarded for taking on the risk of not knowing exactly how things will play out.

If there was no uncertainty, returns would be predictable and there would be no difference between putting your money in a savings account and investing it in the stock market.

Think back to the beginning of the pandemic. At the end of March 2020, the S&P 500 Index was down nearly 20% for the year.[2] Yet investors who stayed in the market were rewarded. At the end of 2020, the S&P 500 Index was up 18.4% for the year, a 38% turnaround from its March lows.[3] March 2020 was a scary time for almost everyone. No one knew what was going to happen. Yet even in those dark moments, I had faith in human ingenuity. When people are met with challenges, they are resilient and work to solve them. Companies are no different. Investing in the stock market means investing in the power of human ingenuity to adapt and innovate.

Because of uncertainty, life is one cost-benefit analysis after another, and we have no choice but to manage risk. At the extremes, some people may try to completely ignore risk, while others might try to eliminate it. Most of us fall somewhere in the middle.

We manage risk with our health, work, family, and just about every other aspect of our lives—including investing—because while few things are certain, we still have to make decisions big and small. For example, we can't control the weather, but we can carry an umbrella if it looks like it might rain. And while we can't predict stock market returns, we can manage the risk in our investment portfolios.

WHAT TO AVOID

One way of managing risk is to eliminate some of the things you shouldn't do. When you want to improve your health, you might eliminate fried foods, soda, and sweets from your diet, which can increase your chance of a healthier outcome. It's the same with investing. Eliminate bad habits, like attempting to predict the unpredictable by trying to time the market or pick winning stocks.

Think of everything that has happened in the past 25 years, including:

- The dot-com bubble
- 9/11
- The Global Financial Crisis and Great Recession
- The COVID-19 pandemic

It would be natural to want to time when to exit and re-enter the market. To put the implications of doing so into perspective, consider a hypothetical $1,000 investment in the Russell 3000 Index made at the beginning of 1999. This turns into $6,449 for the 25-year period ending December 31, 2023. Over that same period, if you missed the Russell 3000's best week, which ended November 28, 2008, the value shrinks to $5,382. Miss the three best months, which ended June 22, 2020, and the total return dwindles to $4,546. See what I mean?

WHAT TO DO

Positive ways of dealing with risk can help you potentially capture the benefits of what scientific research has shown us. With health, that means exercising more, getting regular checkups, and eating more fruits and vegetables. With investing, that means ensuring our portfolios are diversified across regions and asset classes. While it doesn't guarantee making a profit or averting a loss, diversification allows us to reduce our risk while potentially capturing the returns of the market.

Since we know risk is unavoidable—and it's the source of investment returns—you want to find the amount of risk that is right for you. For example, Treasury bills are considered a relatively safe investing asset whose prices don't fluctuate as much as stock prices. However, Treasuries have provided, on average, a lower return than the stock market. Those tradeoffs can be weighed against your specific needs and preferences, and it's always good to be prepared for a range of outcomes. The more committed you are to a philosophy and a plan you can count on when you are experiencing the ups and downs of uncertainty, the more likely you are to succeed as a long-term investor.

YOU ARE ALREADY BETTER AT THIS THAN YOU THINK

You know more about investing than you think you do, because investing is all about risk and reward, just like every other part of your life. In investing and in life, some years are better than others, but the important thing is to be able to persevere so you're ready for what comes next. That's why I see uncertainty as a positive force and have faith in the ability of people to find better ways to manage risk. I've worked with thousands of investors during my five decades in finance and seen how, when they manage risk better, they live a better life. Instead of trying to predict your future, plan, adapt, and figure out the most sensible solutions for you.

You might not only be underestimating uncertainty—you may be underestimating the positive impact of embracing it.

1. In US dollars. Based on S&P 500 index annual returns, 1926–2023. S&P data © 2024 S&P Dow Jones Indices LLC, a division of S&P Global. **Past performance is no guarantee of future results.** Indices are not available for direct investment; therefore their performance does not reflect the expenses associated with the management of an actual portfolio.

2. Decrease of 19.6% was from Jan. 1, 2020–March 31, 2020. Increase of 38% was from March 31, 2020–December 31, 2020.

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