Back to the Basics: History of the Stock Market + The Power of Compounding

Dave [00:00:00]:

All right, folks, welcome to Investing for Beginners podcast. Today we're going to continue with part section two of our back to the Beginners series. So this is a series that we're going to continue for 18 more episodes, and we're going to continue to do them every week. So one a week till we work through all of our shows. So today we're going to talk about the history of the stock market and compounding. So let's start talking about the history of the stock market. So, Andrew, do you want to go ahead and start with our history lesson here?

Andrew [00:00:30]:

Okay. How far? It depends on how far back you want me to go.

Dave [00:00:34]:

Could we go back to the time of, let's see, Babylon? Would that be too far back?

Andrew [00:00:40]:

My memory from that time period is just a little shaky. Apologize. Some of the years just kind of fly by.

Dave [00:00:48]:

How about we do the last 100 years?

Andrew [00:00:50]:

All right. Fair. I don't know. So when I thought as a beginner, kind of thinking about the stock market, the Great Depression kind of stood out to me this time where the stock market crashed and then the whole economy just exploded, basically. That's kind of the stereotype I've always had about the stock market. But stock market has been around for longer than that. Something like the 18, maybe 1850s, 1880s. It was definitely around.

Andrew [00:01:20]:

In what country is Dutch? Now I'm sounding like an ignorant american. In the Netherlands.

Dave [00:01:27]:

Yeah, the Netherlands.

Andrew [00:01:28]:

The Netherlands. They were the first stock market with the blanking on the name.

Dave [00:01:34]:

The Dutch East Indies trading company.

Andrew [00:01:36]:

Yes. Thank you.

Dave [00:01:37]:

You're welcome.

Andrew [00:01:38]:

So the stock market is not an american thing. Sorry, my fellow us warriors. It's been around for a long time, and it's survived many, many great global events. So in the time that the stock market has been in the United States, we've seen the civil war, we've seen World War I, World War II, Great Depression, everything else, two pandemics. Right. So the stock market's been around for a long time, and even though there are headlines around it, it's pretty much worked like we would have all hoped. And so what I mean to convey with all of that is the stock market is not some new thing. It's not some super risky thing by itself.

Andrew [00:02:25]:

It's not this crazy magical vehicle. It is simply a place where businesses trade and have been traded for a very long time. And so when you put your money into the stock market, although it can have a bad rap sometimes when things go crazy, it is not some super risky casino that you're gambling into. What it is really is you're buying ownership stakes in businesses. And that is a very different proposition than trying to become a day trader on Wall street. So I think the first step, if stock market is intimidating or you feel like you can't figure it out or you can't use it to build wealth, is to understand, take it off its pedestal. It is not some super complex thing. It's been around for a long time and it's worked pretty well.

Andrew [00:03:24]:

And, oh, by the way, if you would have bought some stocks a long time ago and just held on, you'd be generating lots and lots of wealth. And you can still do that today and do that for the next couple of decades, many decades. Whatever it is, it's a fantastic vehicle for building wealth if you can do it in the right way.

Dave [00:03:43]:

Yeah, exactly. As you said, it was designed to allow people to partake in the businesses that were operating in that day and time. And it has evolved into this very complex system of lots of people buying and selling stocks on a daily basis. And I guess maybe to kind of back up a little bit when you think about a stock, you have to understand that a stock is really partial ownership of a business. So whether it's General electric or whether it's Microsoft or whether it's a very small company, it's all the same idea. You're owning a partial share, you own a piece of that business. And so you are a shareholder of Microsoft. And therefore, when Microsoft does well, you receive the benefits of it doing well.

Dave [00:04:38]:

Likewise, when it does poorly, you also receive the benefits of it doing poorly. And I admit, when I first got into the stock market, I thought of them as tickers. I thought of those electronic signals going across your computer at work that you're not supposed to watch, that these were just tickers. And it wasn't until I started reading Warren Buffett and really started to understand that, hey, I'm buying a partial. When I buy Activision, that's a partial ownership of that particular company. And so it made sense to me once I figured that out, that now I need to figure out how to understand the business that I'm buying. Because now, as a shareholder of that company, I'm not directly responsible for its performance, but I am responsible for my ownership of the company, and I don't want to buy it. Nobody wants to buy a bad company.

Dave [00:05:34]:

And so then it becomes okay. Now I got to start to figure out how these companies work. And then understanding, when you own the share of stock, you own it at a particular price, but somebody may be willing to buy it from you at a higher price, or likewise, they may be willing to buy you from you at a lower price. And so that's kind of how the stock market works, is that there's all these people, if you think about it as kind of a ladder and you think about all these people kind of coming in and out saying, hey, I'll buy your share of Microsoft for $50, or if you sell it to me for $42, I'll take it. That kind of thing. So there's just equal and opposite sides of the market. It's not just everybody just buying. There's also people selling shares, too.

Dave [00:06:21]:

And you can't buy a share of this company without somebody being willing to sell it. And so that's very important to that. And it hasn't changed since the Dutch East India trading company. That kind of whole idea of buying and selling has remained the same from time. So once I learned that, that helped me realize that, hey, maybe this isn't quite the casino. I felt like it was like it wasn't just totally throwing dice and just gambling, like, hey, yeah, sure, I'll buy this. I don't know. I think once you start to understand how the stock market works and what it is and what you need to look for, then it becomes a little less, I guess, mythical, I guess, is the best way of putting it.

Dave [00:07:11]:

So I liked your illustration of putting it on a pedestal, because when I first got started, that's the way I felt about it, too. It was very much a pedestal that I kind of, like you were saying earlier, that it's for the rich and it's not for the average, every person. And that's not the case at all.

Andrew [00:07:27]:

No. And what's great about the stock market is it loves to be dramatic a lot of the time. And so every time we get a good period of time where the market's normal and rational and people are making money and everything's calm, just like the human race likes to do calamity strikes and you get a whole new breed of bad behavior on Wall street. And we saw that happen during GameStop and that whole fiasco and some of the tragic stories of people who lost money. And so those things are also part of the market. But that is what ends up happening when you have, like you said, this illustration of the ladder of a group of people buying and selling and people trying to take advantage. That does happen. But over the span of time, over long stretches, the stock market and the stocks that are in the stock market will follow the performance of the businesses that are underlying it.

Andrew [00:08:29]:

And so over the very long term, the economy grows because businesses grow as they hire more people, try to become more innovative, and people want to go up that next step in the ladder in their own personal lives. And as that happens, the stock market also goes up, too. And so if you pull up a chart, if it's a good stock, you'll see this chart. But if it's just the stock market as a whole, you can pull up a chart. In the short term, it's very up and down. It's very volatile, bumpy looks, ticker ish. But the more you zoom out, five years, ten years, 20 years, you start to see this progression, this growth line from the bottom left to the upper right. There's some volatility or swings up and down along the way.

Andrew [00:09:17]:

But as a business grows, as the economy grows, you see that growth in the stock price as well. And that's where the magic happens. It's just in those little pieces of the day, different days, where things go out of whack, people panic, things go crazy. You do get unfortunate events. But for the people who understand how the stock market works, understand how it's going to make them money and are able to find the right businesses and hang on to them through the chaos, those are the ones that find compounding wealth.

Dave [00:09:50]:

Yes, exactly. And herein lies the importance of really understanding the stock market and some of the history of it. As Andrew was pointing out, there have been peaks and valleys. We have endured quite a lot of different traumatic events in the last 70 to 100 years that Andrew already illustrated. And the point with all that is, number one, it all remains the same. Through all those trials and tribulations that we as a people in the United States have endured, we have seen the economy and the stock market continue to grow. And even though there's been world wars and horrible pandemics and just all kinds of crazy stuff, even in the last five to ten years, we've seen a lot of upheaval. But if you zoom out over those ten years, you still see going from the bottom right, from the bottom left, I'm sorry, to the top right, going, moving up.

Dave [00:10:45]:

And so that helps you when you're going through a downturn, because you're going to see it. Nothing you buy is always going to go up to the right. Even Nvidia, as hot as Nvidia is right now, it will not continue forever. It may continue for two, three, five years, who knows? But it won't last forever. And so there are some things in the stock market that are absolutes. Number one is the good times are not always going to last. There will be hard times. But the flip side of that is knowing the history of the stock market, you may experience downtimes in an investment, but if it's a good company, over a long period of time, you will see growth.

Dave [00:11:28]:

Warren Buffett and Charlie Munger endured 350 percent or greater downturns in the time that they've owned Berkshire Hathaway. So imagine the value of that cutting in half. So going from $100 to $50 a share kind of thing, that's serious. And those are hard to stomach. But like Andrew said, if you zoom out and look at a long period of history, you can see it growing over that long period of time. And so understanding the history of the stock market and understanding that these things are going to happen and it's part of the investing game can help you ride out those hard times and continue to continue to invest in the stock market. The other thing about knowing the history is that this time, some of the most dangerous words in the stock market are this time it's different. It's never different.

Dave [00:12:19]:

It never ever. So if you go back, it's no more stark. If you go back and read investment letters, if you read Warren Buffett's investment letters and you go back and read during the years ago, yeah, 50 years ago, and some of the things that were going on then are happening now. And it's not because that this time is different. It's because human beings are the ones operating in the stock market, running the businesses, making decisions about buying and selling companies and this, that and everything. So in the last 50 years, therefore, the stock market and things that happen in the stock market don't change that much. And so to me, that's very comforting, knowing that the history is there and it's out there for us to see. And once you kind of learn some of these, I guess, time tested rules, it'll help you withstand the ups and downs of investing.

Dave [00:13:12]:

Because again, to go back to it, it's not going to be all sunshines and roses every time. A couple of years ago, it was all death, doom and despair, and now it's all sunshines and roses. So it can change. Sometimes it can change quickly, but it's all part of the game. And it can help you ride out those hard times to know that the stock market is going to go up to the right.

Andrew [00:13:32]:

So are there any other aspects of the market, things about the history of the market that a beginner should know that can help them build conviction or just be a good thing to keep in the back of their pocket to remember as they're investing in the stock market.

Dave [00:13:49]:

That's a good question. You don't have to be a history student of the stock market. I think if you just understand the basics, that the market was created as a way for average people to create wealth and generate wealth for themselves and to be buyers and sellers of some of the best, potentially some of the best businesses in the world, and be able to do that on a regular basis can help you withstand some of the ups and downs and the trials. And a Ben Graham wrote this fantastic book called the Intelligent Investor. In one of the chapters, I believe it's chapter eight, he talks about this figure called Mr. Market, and he used this kind of crazy person as an illustration of how the market is going to show up every day and offer you all kinds of wild and crazy deals. There are going to be days where a company you invest in, I believe it's alto networks, easy for me to say, didn't have a great quarter a couple of days ago and they dropped 25% in one day. And so that's a really big drop.

Dave [00:14:52]:

Whether it's justified or not, time will tell. But those are kinds of some of the things that you can see sometimes when you're investing in the stock market. Andrew was talking about GameStop and that whole craziness. Those are things you can see in the stock market, but that doesn't mean that that's going to be the everyday thing. And that doesn't also mean you have to partake in those. You have a choice of what you want to buy or what you want to sell, and you don't have to go and play every single day. And I think if you understand how the market works and understand the history of the market, I think it can help you withstand some of the ups and downs and help you give you motivation to continue to keep investing. Because the only way to grow your wealth is to play the game.

Dave [00:15:36]:

And if you stand on the sidelines and wait for the air, quote perfect time to buy said company b, that time is going to either never come or it's going to pass you by because you weren't paying attention. So it's better to be consistently playing the game than trying to time the game. That has never proven to work, and that's another history lesson. It doesn't work. So I think once you kind of understand some of the history and the mechanations of how the stock market works, that can really help, I think, overcome some of the hesitancy and also some of the fear of investing in the stock market. It's not a casino. It's a place for us to go and bid on what we think is a fair price for a good business and partake in all the effort that Satya Nadella does and we don't have to do. Thank goodness.

Dave [00:16:22]:

Yeah. So how does the stock market and everything we've talked about so far, how does that kind of correlate with compounding and the power of compounding?

Andrew [00:16:30]:

Yeah, good question. Compounding is kind of the secret sauce of the stock market.

Dave [00:16:35]:

Right?

Andrew [00:16:35]:

This is really what makes the thing that Dave was talking about earlier about how average people can generate great wealth from the market, that all stems from compounding. So it's hard to visualize unless you see a visual. But if you think about like a snowball running down the hill, it's kind of time consuming to make a snowball, especially if you're starting from scratch. You have to start with a little bit of snow. But if you can build up a decent snowball and then you can push it down a hill, as it rolls down the hill, it picks up more and more snow. And as it gets bigger, it picks up even greater amounts of snow. And that's what happens with your investments in the stock market as well. The stock market is like that downward Hill for your wealth.

Andrew [00:17:24]:

And what it's doing is you're putting money to work and that money is making more money. So you mentioned Microsoft, for example. Microsoft today, let's say, I don't know, just throw a random number out there. Let's say they're generating 30 billion in profits this year. That's awesome, right? Great. They're a great business. But what do they do with those profits? A company like Microsoft, because they have a cloud business, they might take some of those billions and reinvest them into some servers in order to expand and be able to serve more customers. So next year they'll be able to serve even more customers and generate even more revenue and even more profits.

Andrew [00:18:09]:

And that cycle continues and it continues with every business that grows and that can be really powerful for people. How do you look at compounding?

Dave [00:18:16]:

I love the know that is, I think one of the best illustrations. As the snowball rolls down the hill, it gets bigger and bigger. And to me it's easy to visualize. And I think was it Albert Einstein that said that compounding was the 8th wonder of the world? And those who don't understand it, fail to benefit from it. And if you think about it, it's a simple concept. You have a savings account. You put some money in a savings account, it earns interest, and that interest builds up the pile, and then that interest earns interest on that interest, and it just kind of continues to build the pile. And the magic happens when you start to achieve where the compounding starts to happen on the compounding.

Dave [00:18:59]:

And so it continues to kind of build on it. And I know that's why you like dividends so much, is because those are extra snow. You could put on a snowball to help build that. And I think one of the ways that I've always kind of liked to look at it is kind of looking at an investor like Warren Buffett. And I'm going to read you some stats here to give you kind of maybe, hopefully, a visualization of the power of compounding. So when

Warren Buffett was 53, he was worth $620,000,000 by the time he was 59. So six years, he had grown to 3.8 billion. By the time he was 72, that was 36,000,000,083.

Dave [00:19:42]:

That was 58.5 billion. And 92, it was 109,000,000,000. And now I believe he's worth over $140,000,000,000. So it's gone from a little bit from 620,000,000. Not that that's small, but reference wise, 620,000,030 years later, he's worth 140,000,000,000. And those are big boy numbers and or big person numbers. And so that can be, to me, that's very illustrative and shows the power of investing and continuing to put money into the stock market and helping it continue to grow, because that's really the only way that this is going to happen, is by continually trying to put money into the market. And when you do that, and with great companies, then that can compound on itself.

Andrew [00:20:30]:

And you mentioned millions and billions, and maybe some people might start tuning that out.

Dave [00:20:36]:

Right.

Andrew [00:20:36]:

Take out the million and take out the billion.

Dave [00:20:39]:

Right.

Andrew [00:20:39]:

$620 turning into $140,000 in 30 years.

Dave [00:20:47]:

Yeah.

Andrew [00:20:47]:

Where else can you do that?

Dave [00:20:49]:

Nowhere that I know.

Andrew [00:20:50]:

And that's because of compounding. I mean, yeah, he's a brilliant guy. Yeah, he had a lot of money. But the math of compounding is the same, whether we're talking about starting with $600 or $600 million. If you invest and you earn returns, that compound, you can turn $600 into $140,000, just like Buffett turns 620,000,000 into 140,000,000,000.

Dave [00:21:17]:

Right.

Andrew [00:21:17]:

The exact same math. And it's possible for everybody.

Dave [00:21:21]:

Yes, exactly. And whether it's 9% or whether it's 11% or 12%, each percent can make a huge difference over long periods of time. I'm not going to bore you with numbers, but just going from 10% to 11% can have a huge impact on the returns that you can have. Just like going from 6% to 8% can have a master monster effect on the kinds of returns that you can earn over a long period of time. And that is the magic of compounding. Basically, what you're doing is, as Andrew said, you're getting your money to work for you. And that's what we all want. We don't want to work harder.

Dave [00:22:00]:

We want to work smarter. And using compounding can help you work smarter.

Andrew [00:22:04]:

I wonder if, like the snowball metaphor, if you think of each percent as almost like, I'm embarrassed to even say, yeah, thank you. Like a grade.

Dave [00:22:13]:

Yeah.

Andrew [00:22:14]:

So if you're generating, like, one or 2%, the slope is really shallow.

Dave [00:22:19]:

Right.

Andrew [00:22:20]:

But if you're lucky to get to 2020, 5%, like you bought Apple or Microsoft a decade or two ago.

Dave [00:22:27]:

Right.

Andrew [00:22:28]:

It's like a straight drop down with your wealth, and it becomes an avalanche.

Dave [00:22:34]:

Right.

Andrew [00:22:34]:

Snowball becomes an avalanche. And that does happen since you didn't want to bore everybody with numbers, I'll guess I'll do that myself. If you bought Apple when they came out with the iPhone in 2007. So you put five grand into that, and you look at where the stock is today. You have $234,000 from five grand and did nothing else.

Dave [00:22:56]:

That's nothing else.

Andrew [00:22:58]:

I like the iPhone. I'm going to put five grand in Apple stock. Yeah. That is like a special snowflake kind of stock. Like, there are not many apples of the world, but they earn 26% annually for 17 years. About. It's a great result, but it's not like this is the best result we've ever seen.

Dave [00:23:21]:

Stocks.

Andrew [00:23:21]:

There are stocks and businesses that do this over and over again throughout history. The possible. And that's what's so fun, I think, about being able to profit from compounding is. Okay, here's one more math problem, I promise.

Dave [00:23:42]:

Okay.

Andrew [00:23:44]:

I told you they compounded it. It's actually 26% annually, but let's just say 25 to make it easy. That doesn't sound like a lot. And whether you're talking about, like, $600 or the five grand we were talking about in one year, 25% on your money would turn your five grand to a little less than 6500. So it's like, whoopi, I made $1,000 doesn't sound like a lot. And if you start at, like, 600, whoopi, I made, like, $60 doesn't sound like a lot, even when you're having an apple like return.

Dave [00:24:14]:

Right.

Andrew [00:24:14]:

But where the magic of that comes in is over the years, as the money makes money on the money and the money makes money on the money, and the money keeps working on it. That's where you can see the great results. It's just we all want the result now. We're not willing to wait ten years, 17 years, 20 years. That's where the magic can happen with compounding is if you can afford to wait, and that's ideally what you're doing. If you're investing money in the stock market, you're putting it in there and you're holding on and you're waiting, right?

Dave [00:24:45]:

Yeah, exactly. And I think both of those examples plus the Warren Buffett example also illustrate the point that to partake in this wealth, you have to invest in the stock market. Warren Buffett is worth

140,000,000,000. And it's not because he makes a lot of money. His salary is pitiful, comparatively. He owns a 900 billion dollar company, and I think he makes 250,000 a year or something like that. That's his salary. He doesn't make much.

Dave [00:25:17]:

If you own apple, like Andrew was talking about, that's the only way that you can grow. Take $5,000 and turn it into that kind of result is by owning shares of that company. And so that's where the magic of investing can really start to take hold, is when you own these companies that perform really well for a long period of time, that's how you grow your wealth.

Andrew [00:25:35]:

So any tips for somebody getting started wants to go like we all do. They want to turn five grand into 234,000.

Dave [00:25:43]:

Close your eyes, take a dart, and throw it against a wall with tickers. No, I'm joking. You have to start. If you've never invested, you have to start. You have to buy something, and you have to put money in the market to start to snowball. The only way to start the snowball down the hill is to walk to the top of the mountain and put some snow down. And if you don't, then you can't start this. So you have to start.

Dave [00:26:04]:

You have to figure out something that you can buy, whether it's Netflix, Amazon doesn't matter the name. The first name is not going to be the one that's going to make you. Your untold wealth could be, but unlikely.

Andrew [00:26:18]:

Only if it's Microsoft.

Dave [00:26:19]:

Yeah, right. Or apparently Apple. If you'd done it in 2007, if you had been pressing it and thought ahead back then, then you could have done it. And then you have to start learning what you don't know so that you can start learning how to find these great businesses like Apple. You can look towards mentors like Andrew, and the value spotlight can help you on the path to a, finding great companies and b learning how to find great companies and the continual learning process. And you have to be patient with yourself. You're not going to be Warren Buffett. Well, you may be, but more likely than not, you're going to be like me.

Dave [00:26:57]:

You're going to just have to learn and make mistakes and learn from those mistakes and try to find the best companies that you can. Don't chase fads. Don't try to find the next hot, great shiny object. It's okay once in a while to try to look for that just for fun, but don't put all your money in it. But just basically try to learn and start and be patient and understand that there's a process that you need to follow. And if you stick with it long enough, you will start to find things that will compound for you and then you'll discover the magic of this. Could be lucky. You could be the first two or three things you buy.

Dave [00:27:30]:

It may take a few after that to find other ones. So it's all part of a process.

Andrew [00:27:35]:

Yeah, I love that. I don't think I'll add anything to that because that was really good.

Dave [00:27:43]:

All right, I got the last word. All right, folks, well, with that, we'll go ahead and wrap up our show for today. I hope you enjoyed our discussion on the history of the stock market and compounding. We try not to use too many numbers and these are powerful forces and you have the time and ability to put those forces to work for. Good for you. So start today. If you haven't started today, I encourage you to go out and start today and get started compounding, building your snowball. So with that, we'll go ahead and sign us off.

Dave [00:28:13]:

You guys go out there and invest with the margin of safety. Emphasis on the safety. Have a great week and we'll talk to you all next week.

We hope you enjoyed this content. Seven steps to understanding the stock market shows you precisely how to break down the numbers in an engaging and readable way with real-life examples. Get access today@stockmarketpdf.com until next time have a prosperous day. The information contained just for general information and educational purposes. Only it is not intended as a substitute for legal, commercial, and or financial advice from a licensed professional review, our full disclaimer@einvestingforbeginners.com.