

Client's Corner

It's the Earnings, Stupid

AROUND THIS TIME IN 1992, A HITHERTO UNKNOWN political strategist was working hard to get his client, Arkansas governor Bill Clinton, elected president. James Carville observed that the governor was something of a policy wonk, inclined to give long, complex answers on any and every issue. Desperate to keep the campaign focused, Mr. Carville posited three critical themes he believed they should be relentlessly pounding away at. One of those themes went straight into American folklore—where it remains—as the admonition “It’s the economy, stupid.”

Although this may strike the reader as a somewhat long way to go for a drink of water, that classic phrase came back to me—with one critical amendment, about which more in just a moment—when I read a recent opinion piece in *Barron's*.

The headline was “Welcome to the New World of Lower Returns. Where to Invest Now.” I quote the first two paragraphs verbatim, though I have added certain emphasis.

“Most of what people expect in the future is based on what they’ve known and experienced in the past. For investors, that has generally meant rising prices and strong total returns for the past four or so decades, with nasty interruptions along the way—most recently, the steep drop in stocks during the Covid crisis, the 2008-09 financial crisis, and the bursting of the dot-com bubble in 2000-01.

“In every case, however, stocks rallied back, ***fueled in large part by aggressive Federal Reserve easing.***”

You know already from the headline where the *Barron's* essay goes from here. It’s an expression of the writer’s declinist opinion—or that of a collection of three “experts” carefully selected to be similarly pessimistic—that future stock market returns are going to be lower than they were in the past. This hardy perennial has appeared in some or another financial publication about every month that I’ve been in the financial services industry, meaning that I’ve seen it...well, let’s just say several hundred times. But try to set that aside for the moment.

Likewise, give the writer a pass for damning with faint praise the great resilience of the U.S. equity market—

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which has not merely “rallied back” from significant declines but gone on to achieve dramatically higher values. The dot-com bubble burst in March 2000 with the S&P 500 at 1,527. After that cataclysm—and the two huge subsequent crises *Barron's* cites—it’s at 5,800 as I write. Set this aside too, if you can—allowing me finally to focus on the italicized attribution of stocks’ remarkable performance “in large part [to] aggressive Federal Reserve easing.” Excuse me, but that is the wrong conclusion. To paraphrase James Carville, it’s the earnings, stupid.

A hundred thousand dollars invested in the S&P 500 when it topped out in March 2000 and left to compound (taxes paid from another source) had grown to about \$585,000 at the end of this April. You would need to be an economic illiterate or a financial journalist to think that accretion of wealth could happen “in large part” due to even the most wildly accommodative Fed policies. In a few snapshots, here’s how it actually did happen in the real world:

- The earnings of the S&P 500 Index shot up from \$51.68 for the full year 1999 (just before the bubble burst) to \$243.32 in 2024—just shy of quintupling.
- Following right along, the Index’s dividend rose from \$16.71 to \$73.40 in the same period, up about 4.4 times. (You didn’t ask, but the Consumer Price Index went up less than 2x, meaning among other things that people who retired on their dividends 25 years ago have seen their cash income significantly outpace the cost of living.) But the dividend was the caboose; earnings were the engine.

- And what was the economic basis for this exceptional financial performance? I'm hoping that by this point you've accepted that it can't have been "aggressive Federal Reserve easing." What then? A partial answer: the powerfully accelerating productivity of the American worker, and his/her contributions to the economy. Specifically: real GDP per capita—that is, *net of inflation*—went up a startling 40% from the fourth quarter of 1999 (\$49,281) to that of 2024 (\$68,872). You couldn't have been blamed, as 1999 was winding down, for assuming that such a quantum leap was no longer possible in an economy as fully developed as ours.

In the long run—which is what goal-focused, plan-driven investors are in it for—companies sell for some function of what they earn, and what they are therefore able to pay out in dividends. Interest rates rise and fall, the stock market cycles from terror to euphoria and back again, Fed chairs come and go, and so do presidents. But at the end of the day...it's the earnings, stupid.

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Sources: Levels of the S&P 500: Standard & Poor's, Yahoo Finance. Compound growth of \$100,000: the S&P historical return calculator (with dividends) on the website "[Of Dollars and Data.](#)" CPI and real GDP per capita: Federal Reserve Bank of St. Louis (FRED).