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The Real Value of the Gift of an Investment

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If we could teach young people just one thing to improve their chances of financial success, it would be the concept of compounding. Only when your investment gains begin to earn investment gains of their own are you truly on the path to building meaningful wealth. The earlier in life young people understand this, the better off they will be.

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Yet this message isn't getting through. In the most recent global study of financial literacy, published by S&P Global, the World Bank and Gallup in 2015, the U.S. ranked just 14th in the world when it comes to understanding basic concepts such as diversification and compounding. This shouldn't come as a shock, as only 17 states require high school students to take personal finance courses, according to the Council for Economic Education. What's more, two thirds of parents say they are reluctant to talk to their young people about money, according to recent polls. There is a simple way to jumpstart this conversation while simultaneously demonstrating how the markets work and why it pays to invest early and stay invested: give your children or grandchildren the gift of an investment.

This may not seem very personal, but young people are already predisposed to receiving a financially-oriented gift. Two of the most popular graduation presents these days are cash and gift cards, according to the National Retail Federation. Plus, we're not talking about old-fashioned savings bonds, which young people have been getting from grandparents for generations and that currently pay just 0.10% in annual interest. These days, parents can just as easily gift shares of companies their children can appreciate like Apple or Netflix or Nike. Or better still, gift them shares of a mutual fund that offers exposure to the broad market, which will teach them about diversification and why it pays to stay invested for the long run.

Part of the benefit is simple: We need to boost young investors' overall exposure to equities. A recent report by the Federal Reserve Bank of St. Louis found something discouraging: Even though young people should have a greater percentage of their investments in stocks than older workers do, owing to their longer time horizons, that's not what's going on in the real world. The St. Louis Fed found that households with investment accounts, headed by workers younger than 35, held just 40.2% of their portfolios in stocks, on average, in 2016. This is considerably less than the 50.2% equity stake for households headed by those 65 to 74.

A survey conducted by Gallup last year found that only 37% of young adults (those younger than 35) owned stocks in 2017 and 2018, down from 52% before the 2008 market crash. Apparently, the effects of the global financial crisis and recent stock market volatility linger in their psyche.

Yet if a millennial owned shares of a broadly diversified equity fund back then, they would have witnessed several important things that would have helped shape their understanding of the markets:

- **Stocks may sink from time to time, but over the long run they go up.** Say a millennial invested $1,000 in the average blue-chip U.S. stock fund on Oct. 9, 2007, when equities slipped into a bear market. Yes, that original investment would have shrunk to $460 by March 9, 2009. But by staying invested, young investors would have learned a valuable lesson. Within about three years, they would have recouped all of those losses, and by Dec. 31, 2018, that original $1,000 investment would have grown to $1,750. That's roughly $700 more than they would have earned had they "played it safe" in 3-month T-bills.
- **Stocks rise more frequently than they fall.** Even in the worst decade for the markets since the Great Depression, from the dotcom crash in 2000 through the end of the Great Recession in 2009, something interesting occurred. While stocks fell four times (2000, 2001, 2002, and 2008), the market rose in six of the other calendar years. This mirrors a much longer-term trend: Since 1926, what is now the S&P 500 has risen in 68 calendar years, which represents a success rate of more than 74%.
- **"Timing the market" is bad.** One thing owning stocks will teach you is not to trust your instincts. Some of the worst years for equities have been followed by some of the best years. For instance, the S&P 500 rose more than 26% in 2009, after falling 37% in 2008. Trouble is, you won't enjoy those surprising up years if you follow your instincts and head for the exits when things look scary. This explains why the investment returns that individuals earn are almost always less than the market return that a fund produces, according to Morningstar.
- **"Time in the market" is good.** If young people can learn just one thing from owning stocks, let it be this: the younger you start, the more rewarding it is. It's that simple. If an 18-year old is gifted $1,000 in a blue-chip stock fund today, and then invests just $1,000 more every year for the next 49 years, and keeps reinvesting the gains, he or she would wind up with $1.2 million by age 68. This assumes that blue chip U.S. stocks will continue to deliver 10% annualized returns as they have since 1926, according to Ibbotson Associates.

But let’s say you procrastinated. How much would it take in annual investments to get you to $1 million if you wait until turning 35? Roughly $4,500 a year. And if you wait until you turn 45, you’d have to sock away more than $12,500 a year to get to seven-figures.

It just goes to show how valuable an investment gift can be. While the savings bonds mentioned earlier may seem quaint today, they played an essential role in rebuilding Americans’ confidence and finances. For families who lost wealth and faith in the aftermath of the Great Depression, government savings bonds offered a tangible lesson in how to rebuild savings and restored hope that a college education or a home would one day be within reach for their children.

In the aftermath of the global financial panic and Great Recession a decade ago, an investment gift in stocks or a fund can teach real lessons in why it pays to invest early and stay invested.

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