Why Generation Y Needs The Stock Market

Description

Generation Y has given up on the stock market.

In a recent Wells Fargo poll, more than half of Gen Y (those between the ages of 22 and 32) adults surveyed answered that they were ‘not very’ or ‘not at all confident’ in equities as a place to invest for retirement.

In another survey by MFS Investment Management, 40% of Gen Y respondents agreed with this statement: ‘I will never feel comfortable investing in the stock market.’

In both reports, Gen Y answers were more risk-averse than Gen X or Baby Boomers. That’s a remarkable statement because, intuitively, it should be the opposite.

But this generation’s fear of equities is one of the biggest financial mistakes they could make.

Warning: Generation Y is making a big mistake
It’s not hard to see why an entire generation has been turned off of equities.

Over the past decade we’ve seen two gut-wrenching bear markets. Investors don’t have much to show for ten years of patience. It sure seems like a risky place to stash your money.

But this is an entirely wrong way to think about risk.

Risk isn’t volatility.

As investors, we shouldn’t care about squiggly lines going up and down on a chart. What we should focus on is growing the purchasing power, or what our dollars can actually buy, of our savings over the long term.

And when viewed through this lens, stocks are the least risky investment around.

The shocking truth about 'safe' investments
Don't believe me? Let's try a thought experiment.

Imagine if all financial markets were to be closed for the next 40 years. You have $100,000 to invest. Where would you allocate it?

Why 40 years? The median age for the Gen Y demographic is about 25. Closing the market for 40 years would put them right into their retirement age.

As the surveys have indicated, most of Gen Y is figuratively (or not) sticking their money under the mattress. After 40 years of earning 0.1% in your chequing account, your nest egg would be worth $104,079.

Ah, but we forgot inflation. That nagging factor courtesy of our central bankers. Assuming a 2% bite for inflation, in real terms your savings are actually worth $46,426.

Other safe investments like guaranteed investment certificates or treasury bills won't do much better. Their merger yields will barely keep up to inflation. Perhaps you'll do alright if interest rates rise. But after taxes your gains are negligible.

Doing the 'safe' thing is actually quite risky.

If you don't buy stocks, you'll hate yourself later
Now, what about stocks? Assuming you invested your capital in the **iShares S&P/TSX Capped Composite Index Fund** (TSX: XIC) and earned a 5.5%, your nest egg would be worth $851,331 when the markets reopened. In real terms, you would have almost quadrupled your investment.

It's a staggering thought. But assuming a relatively modest 5% to 6% return over 40 years, the **S&P/TSX Composite Index** (^GSPTSE) could one day be trading north of 100,000 points! That the power of compounding over decades.

Are these assumptions realistic? I based my returns figures on long-term averages which in no way assures anything about the future.

But the last 40 years have been a rough ride…the National Energy Board…the crash of 87'…the Asian contagion…Long Term Capital Management…the technology bust…the Halloween Massacre…the financial crisis. Yet through all of this, stocks have still posted impressive results.

If history is any guide, by 2053 we will be some multiple richer than we are today. Corporations will have spun off trillions in profits and dividends to shareholders. In contrast, cash will just sit there eroading in value to inflation.

Foolish bottom line
Sure, it will be a bumpy ride. Be prepared for many stomach churning drops along the way. But when you forget the daily gyrations and look ahead 10…20…40…80 years, which option is really risky? Generation Y, it's time to get over your fear of stocks.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:XIC (iShares Core S&P/TSX Capped Composite Index ETF)

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