



The Reason Optimists Earn Higher Returns

By [Alexander Green](#)

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Surveys regularly show that the majority of Americans believe the nation's best days are behind us, that our children face a diminished future, and that the country is decidedly on the wrong track.

If you truly feel this way, however, it's tough to invest in equities and reap the higher returns that they offer. After all, stocks represent a claim on the dividend distributions and future appreciation of publicly traded companies.

If the present is bad - and the future even worse - why take the risk?

Because things aren't that bad. We live in a golden age... yet most people don't realize it.

Getting Better

On Wednesday, I traveled to the Cato Institute in Washington, D.C., to participate in a forum called "If Everything Is Getting Better, Why Do We Remain So Pessimistic?"

The theme was a bit of an exaggeration, of course. *Everything* is not getting better. The unchecked growth of government is but one example.

However, the folks at The Cato Institute - an organization that conservative columnist George Will calls "the foremost defender of liberty in the country that is the foremost defender of liberty" - know this well. They merely wanted to underscore that the vast majority of human beings alive today have it better than any previous generation.

This comes as news to some people, often because they spend so much time *watching* the news, where crime, war, corruption, pollution, terrorism and political dysfunction are recycled 24 hours a day.

Here's what they often miss...

The human life span has never been longer. Formal discrimination against women and minorities has ended. Standards of living have never been higher. Crime is in a long-term cycle of decline.

In the West today, we have tremendous political, economic and religious freedoms. We work shorter hours, have more purchasing power, enjoy goods and services in almost limitless supply, and have more leisure time than ever before. Travel - to the next town or the other side of the world - has never been easier or more affordable. Access to the arts has never been greater.

Senior citizens are cared for financially and medically, ending the fear of impoverished old age. Literacy and education levels are at all-time highs. Technology and medicine are revolutionizing (and extending) our lives. With the exception of greenhouse gases, all forms of pollution are in decline. Despite the headlines, the risk of death by violence has never been smaller. And the Federal Reserve reports that American household net worth is at an all-time record high of \$81.5 trillion.

In short, most of us live longer, healthier, safer, richer and more comfortable lives than our ancestors could ever have imagined.

Why the big disconnect between the way things are and how we perceive them?

Conspiracy of Misinformation

One reason is simply the nature of the media. No one wants to hear about the planes that didn't crash, the buildings that didn't burn or the surfers who weren't bitten by sharks.

Bad news makes good headlines. But it also presents a distorted picture of the world. Positive long-term trends aren't news. Today's disasters are.

As Cato vice president of research Brink Lindsey put it, "The media just doesn't do long-term, incremental progress well."

Harvard psychologist Steven Pinker argued that we are hard-wired to feel pessimistic. It's in our genes.

Our ancestors on the plains of Africa who were nervous and fearful survived and reproduced. The men and women who thought a rustle in the grass was just the wind - not a predator - left fewer descendants. Our brains evolved to do a good job of imagining just how scary things can be.

Pinker noted too that as we get older, we tend to confuse changes in ourselves with changes in the world. From middle age on, we tend to start feeling that young people are less respectful, music is worse, the world is going to hell in a hand basket... and most people "just don't get it."

And let's be honest... the music *was* a lot better.

But then so were we in many ways. When you're young you are stronger, leaner and healthier. Your vision and hearing were better. We had no wrinkles and more hair... or at least it wasn't gray. We were optimistic, even idealistic.

But we change as the decades roll by... and we can confuse our personal diminution with a declining state of the world.

The Benefits of Pessimism

Also, and perhaps subconsciously, many of us *want* to appear pessimistic. Pessimists seem better informed, morally engaged, nobody's fool. It shows you aren't a pesty or a Pollyanna. Why else would so many remain pessimistic even as their worst fears remain unrealized?

In the past, of course, pessimists were eventually proven right. The rise of the Roman Empire was followed by the decline and fall of the Roman Empire. Some people argue that the United States is on the same path today.

Yet pessimism is seldom conducive to stock market success. Legendary investors like John Templeton, Peter Lynch and Warren Buffett had an optimistic outlook on the world that simply didn't have an off switch.

Fearful investors often miss historic market rallies (like this one). They wait for disaster to strike while those of a more optimistic bent enjoy outsized returns.

That could change, of course. And without warning.

In my view, an optimistic investor is not one who blithely puts his faith in higher share prices. History shows that every bull market is eventually followed by a bear market. (And vice versa.) High long-term returns generally come with neck-snapping volatility.

So the smart investor hedges his bets. He invests outside of equities. He diversifies his holdings. And he runs trailing stops behind his individual stocks.

The savvy investor doesn't just hope for the best. He plans for the worst.

The pessimist does only the latter.