

Your portfolio isn't a century-old magical compounding machine

The lived experience of real-world investors is a gauntlet of taxes, fees and the need to spend money

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A LOOK at the long-term chart of the US stock market may make you wish you were born centuries ago, especially since a dollar invested in 1871 would have grown to half a million dollars today.

If the “magic of compounding” works as touted, why isn't Orchard Road cluttered with the descendants of Raffles-era investors who forgot they owned a few shares?

The answer is simple: the returns in financial textbooks are largely mathematical fantasies. A recent report from the CFA Institute Research Foundation titled *Stocks for the Long Run Revisited* describes these mythical gains as “the return nobody got”.

While the charts show a smooth upward climb, the lived experience of real-world investors has been a gauntlet of taxes, fees and the inescapable need to spend money. For the savvy Singaporean investor, understanding why these historical figures are mirages is the first step towards building a realistic retirement plan.

The reinvestment fallacy

Total return figures assume every cent of dividends is funnelled straight back into the market, endlessly fuelling the compounding engine. This assumption is, however, practically and mathematically flawed.

Most investors don't reinvest their dividends; they consume them. An investment made in 1926 that reinvested every dividend would have grown more than 9,000 times by 2022. If those dividends had instead been placed in Treasury bills, it would have grown only 487 times.

In other words, even by choosing to reinvest your dividends in lower-yielding assets, you forfeit nearly 95 per cent of the gains on those academic charts.

It is also impossible for everyone to reinvest everything. Buying more shares with your dividend requires someone else to sell them.

The market simply cannot grow faster than the economy forever; eventually, there wouldn't be enough new supply for all that reinvested cash to buy. Prices would soar to irrational heights and send future returns plummeting.

The US\$100 million entry fee

Today, we can buy diversified, low-cost index funds with a few taps on a smartphone. Unfortunately, for most of history, owning the market was a luxury reserved for the ultra-wealthy.

Before the first modern index fund was launched in 1976, you had to manually buy hundreds of individual stocks to own the "market", and fractional shares didn't exist then. If a US\$40 stock paid a 1 per cent quarterly dividend, you would have needed at least 100 shares to earn enough to afford one more.

To build a diversified portfolio that avoided leaving idle cash, an investor in 1926 would have needed a minimum portfolio of US\$7 million, or roughly US\$100 million today – ambitious for the average Singaporean investor.

Even if you turned to mutual funds, the costs were staggering. Throughout much of the 20th century, loading fees and commissions often exceeded 8 per cent. When you combine these charges with management costs and the difficulty of reinvesting dividends via mail, real-world returns plummeted.

While the theoretical S&P 500 grew US\$1 into US\$333 between 1926 and 1986, a realistic mutual fund return for that same period would have been only US\$137.

The law of “death by a thousand cuts”

Historically, when a family successfully builds a fortune, it rarely survives the “Law of Dissipation of Wealth”. Consider the Rockefellers and the Vanderbilts. Why aren’t those names still among the world’s wealthiest people?

Family wealth tends to lose half its value relative to the economy every 20 years. Why? Simply because families grow. A fortune that supports one founder must eventually support dozens of grandchildren and great-grandchildren. Taxes erode the principal, and the genius that built the wealth isn’t always hereditary.

A 150-year investment horizon is a useful academic exercise, but for a family, it’s almost never a reality.

The danger of American exceptionalism

Another red flag for investors is the heavy reliance on US data. The United States was the best-performing major market of the last 125 years – quite literally the world’s “winner”.

Look elsewhere and the picture is far less inspiring. In many countries, real dividend growth barely kept pace with inflation, and capital gains were modest or non-existent. Focusing only on the American outlier risks mistaking a stroke of historical good fortune for a universal financial rule. As the report warns, assuming that “what’s past is prologue” can be dangerous.

Are lower returns the new normal?

Perhaps the most important takeaway for today’s investors is that the market’s rules may have changed. In the past, high transaction costs meant investors demanded higher returns to justify trading.

Today, those costs have vanished, fundamentally shifting the market’s equilibrium. Since investing is cheaper and easier, more investors are willing to pay higher prices for the same earnings. This helps explain why price-to-earnings ratios now sit well above their historical averages.

Jeremy Siegel, a proponent of long-term investing, argues that “20 is the new 15”. While stocks used to trade at 15 times their earnings, the new floor is likely 20.

The catch? Higher prices today mean lower returns tomorrow. Future real returns may be closer to 3 or 4 per cent, rather than the 6 or 7 per cent we see in the history books.

A call for healthy scepticism

Financial history is messy, and the smooth compounding curves in marketing brochures rarely survive contact with taxes and inflation, and the simple reality is that people eventually spend their money.

For Singaporean investors, the lesson is to favour prudence over propaganda. When confronted with a century-long chart of compounding, ask a few simple questions: Does it include fees? Does it account for taxes? And would a real person have been able to leave that money untouched for a hundred years?

Success in the markets isn't about chasing *a return nobody got*. It's about setting realistic expectations based on *the return you can actually get* in today's lower-return, higher-priced world.

This article has been adapted from a Research Foundation Report that first appeared on CFA Institute Research and Policy Center [here](#).

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