



November 4, 2008

Moving Returns

Stocks on average return 11% per year

Over the past 180 years stocks have, on average, annually returned a full 11% including appreciation and dividend. But, there have been 5 ten year periods when the return has fallen below 2.5% annually including the decade we've just completed. We're all familiar with the past ten years, most of us recall 1964 through 1974 and some may have been around for the depression and remember these puny returns.

Making up for lost time

Of course, there are never guarantees with investing, but the brave ones that stood their ground have always been hugely rewarded exiting one of these "dismal decades" with future returns making up for the lost time.

15.14% annually to make up for lost time

Over the past 30 years the S&P 500 has, on average, returned 8.39%. If in 2028 we can look back at the past 50 years and say we had a normal 11% return, we will need to return, on average, 15.14% annually over the next 20 years. Yes, today's headlines are scary and they may get worse before better, but like other points in history those that stand their ground will be rewarded.

Positive signs

It has been widely reported and accepted that the current credit crunch is responsible for the market turmoil. But, there are significant signs that the credit crunch has begun to recede. The interest rates that banks use to lend to other banks have dropped sharply over the past two weeks as the U.S. Government pumps money into the system. As the banking system unfreezes, lending in the general economy should once again pickup.

Still more recession ahead

Though we have several positive signs which will help in the months ahead, growth will take time to return. Studies suggest that when banks tighten their lending standards corporate earnings decline. But, today's valuations reflect more than a 30% earnings decline, which I believe is unlikely, and historically markets bottom and start to move higher long before earnings turn up.

Surviving adversity

With all of the mistakes of the past decade, a few more regulations should allow us to look forward to a time of less economic adversity. And those that committed crimes will be prosecuted and jailed, warning away future shenanigans. Historically, times of economic adversity have been followed by great prosperity and better markets.

Chart attached

We've attached a separate PDF chart which maps these varying historic returns. The 5 dismal decades are reflected by the blue line meeting the horizontal red line. Evident is that once the red line is touched, future market returns have improved significantly.