



Taking Stock of a Lost Decade: What Does It Mean for the Years Ahead?

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The stock market advance that began on March 9, 2009 brought welcome relief for investors. But a look back over a longer time period reveals a disturbing fact: Returns for the ten-year period ending June 30, 2009 were negative for the S&P 500, which was eclipsed by gains in bonds and cash investments. ¹

These returns beg the question: Does the long-term potential of stocks still warrant their higher risk? For most long-term investors, the answer is yes. But consider the following:

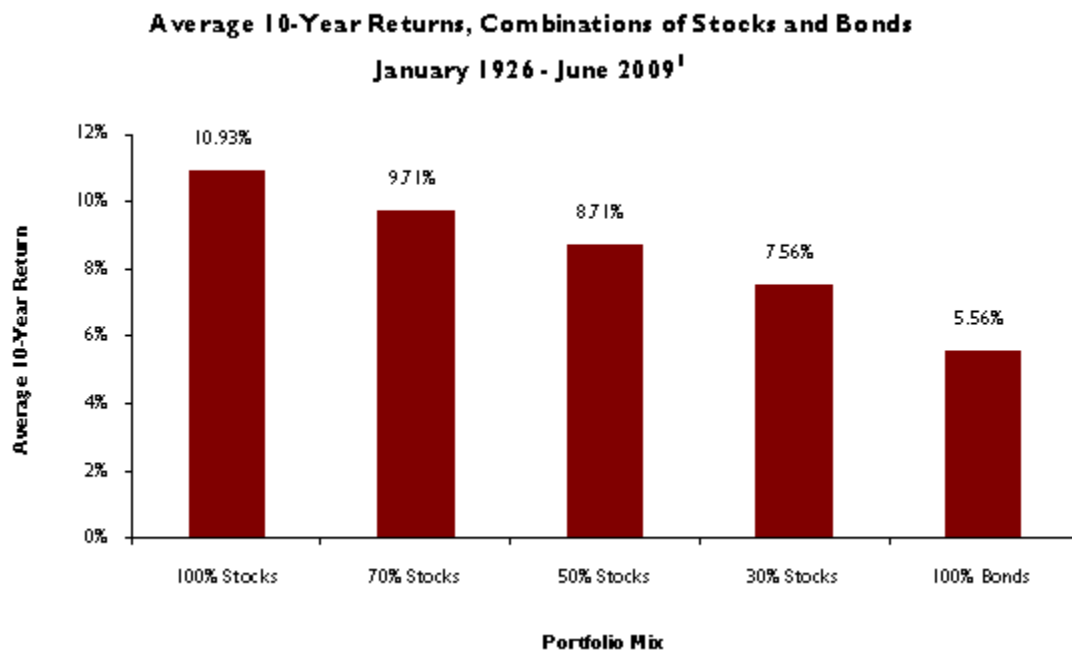
- Although stocks underperformed other asset classes in the most recent ten-year period, they have outperformed on average. For all ten-year periods since 1926, stocks produced average annual total returns of 10.9%, compared with 5.6% for long-term government bonds and 3.9% for cash. ¹
- The timing of cycles is important. The ten years ended June 30, 2009 began when the tech stock boom of the 1990s was about to reach its peak, which was a very tough act to follow. But when considering all ten-year periods since 1926, stocks outperformed both bonds and cash 86% of the time.
- Many stock analysts believe that the most recent market cycle hit its bottom on March 9, 2009, at which point the S&P had fallen 57% from its October 2007 peak. From March 9 through June 30, the index rebounded by 36%. Future performance is likely to depend on the health of the economy, but for long-term investors, the upside for stocks still appears to warrant their higher risk.
- Remember the potential effects of inflation. Many observers believe that a combination of a low federal funds rate and a significant amount of government stimulus intended to recharge the U.S. economy are likely to trigger higher inflation once the economy rebounds. Historically, the annual returns of stocks have exceeded inflation by an average of 6.7%, compared with 2.7% for bonds and 0.8% for cash. ¹

¹Source: Standard & Poor's. Stocks are represented by the S&P 500, bonds by long-term U.S. government bonds derived from yields published by the Federal Reserve and the Barclays Long-Term Government Bond Index, cash by a composite of the yields of 3-month Treasury bills published by the Federal Reserve and the Barclays 3-Month Treasury Bills Index, inflation by the Consumer Price Index. Past performance is no guarantee of future results.

The Case for Stocks

Although the past decade has been a challenging period for equities, there are strategies that can help you reduce the short-term risk associated with stocks. Consider the following:

- Look for attractive valuations. Although stock prices have rebounded since March 2009, as of June 30, all sectors within the S&P 500 remained below their peak in October 2007.² It is not too late to identify stocks or sectors that present attractive valuations with the potential for future gains. Diversified mutual funds present opportunities to invest in a variety of stocks, thereby reducing risk.
- Focus on diversification. Exposure to a variety of sectors reduces your chances of an overall loss when one area experiences a downturn. For the year-to-date period through June 30, 2009, seven of the ten sectors within the S&P 500 experienced losses, but these declines were balanced by gains in three sectors, leaving the S&P 500 with a modest advance of 1.7%.
- Remember asset allocation. The single most important determinant of long-term returns for a given portfolio, asset allocation refers to how you divide your portfolio among different asset classes such as stocks and bonds. Since 1926, portfolios with a mix of stocks and bonds generated average annual returns that approached those of stocks but with less risk.¹



²Source: "Fireworks or Firestorm Ahead?," Standard & Poor's Global Equity Strategy, June 29, 2009.