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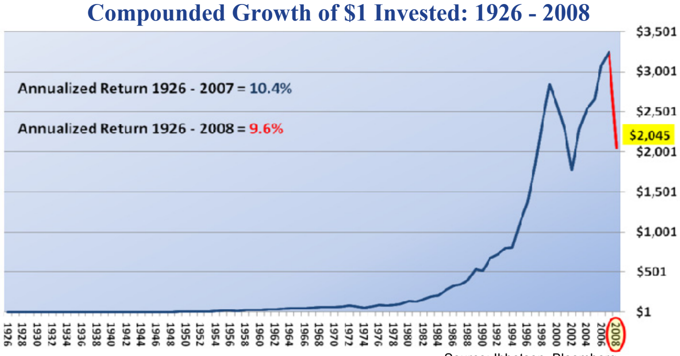
The Sun Will Shine Again

It is news to no one that the equity markets have not been a fun place to be in very recent times. Investors have had to digest quite a bit over the past few months, most of it either decidedly negative or decidedly uncertain. When all was said and done, last year's 37% decline was the second worst year in the history of the S&P 500. This drop was surpassed only by the 43% decline experienced in 1931, during the dark days of the Great Depression. The decline was severe enough that it wiped out the entire advance that stocks had delivered since the most recent leg-up began in early 2003. More distressing to investors is the fact that this current decline has wiped out gains for not only the past five years but also for the past ten. Thus far, the new year has not been much more rewarding as it took a 20% rally from early March lows to limit the 1st Quarter decline in the S&P 500 to only 11%.

Many investors are fed up and giving up. Who can blame them, when several times a day financial news networks are more than ready to report that investing for the long term does not work. To quote a prominent host on CNBC, "Buy and hold does not work, just look at the past ten years." Before throwing in the towel, it is worth taking a deeper look at the returns the stock market has delivered over the 83 year history of the S&P 500, a period that includes the current economic malaise as well as the Great Depression.

Compounded Growth of $1 Invested: 1926 - 2008



Source: Ibbotson, Bloomberg

As you can see in the chart above, the 37% drop in the S&P 500 last year took a meaningful bite out of investors' account values. Inclusive of this sizable pullback, stocks have still delivered an annualized return of nearly 10% since 1926.

Even if you were to dismiss these historical returns as being of little comfort in the current market environment, the bold proclamation that the last ten years is proof that long term investing does not work fails grievously to recognize the unique circumstances of the starting point for the recent ten year period. Ten years ago, the stock market was in the final stages of the longest bull market period in the history of the stock market, a bull run that began in 1982 and did not end until the early part of 2000. On the back of this bull market run, the S&P 500 delivered an eye-popping 478% cumulative return for the ten years ending December 31, 1998. The annualized return over this period was nearly double that delivered by the S&P 500 over its 83 year history. Despite lofty valuation levels, investors could not get enough equity exposure as the economy was strong, corporate earnings were strong, and it was hard to see things possibly going wrong.

S&P 500 Returns: 1988 - 2008

Period	Cumulative Return	Annualized Return
12/31/88 - 12/31/98	478.0%	19.2%
12/31/98 - 12/31/08	-13.0%	-1.4%
12/31/88 - 12/31/08	403.2%	8.4%

Source: Bloomberg

Fast forward ten years to today. First, the bull run ended with the unwinding of the "tech bubble" in 2000 and the terrorist attacks in 2001. As the economy recovered from these events in 2003, so did the equity markets, only to see the next five years' worth of advance wiped out in the current market collapse. In stark contrast to ten years ago, the economy is now very weak, corporate earnings are declining, and it is hard to see how things will ever get better.

As dark as it may now seem, today will likely prove to be a rather attractive time to invest in stocks, particularly for investors with a longer time horizon. The table below lists the ten previous instances in which S&P 500 returns were negative over a trailing five year period. As the data shows, in the previous instances investors were nicely rewarded over relevant forward periods. In most cases, forward returns were meaningfully above the market's long-term historical average.

Historical Perspective – S&P 500 Performance
Following 5-Year Periods of Negative Returns

	Trailing 5 Years	Next 1 Year	Next 5 Years	Next 10 Years	Next 20 Years
1931	-5.1	-8.2	22.5	6.4	11.7
1932	-12.5	54.0	14.3	9.3	13.2
1933	-11.2	-1.4	10.7	7.2	10.7
1934	-9.9	47.7	10.9	9.3	13.1
1941	-7.5	20.3	17.9	17.3	16.9
1974	-2.4	37.2	14.8	14.8	14.6
1977	-0.2	6.6	14.0	15.3	16.6
2002	-0.6	28.7	12.8	?	?
2003	-0.6	10.9	-2.2	?	?
2004	-2.3	4.9	?	?	?
2008	-2.2	?	?	?	?
Average		20.1	12.8	11.4	13.8

Note: Periods greater than 1 year annualized

Source: Ibbotson, Bloomberg

Obviously there are no guarantees, but the fact remains that the market has experienced many dark days in its long history. It may not happen this quarter. It may not even happen this year. But eventually, just as it always has before, the economy will improve, corporate earnings will grow, and the sun will shine again. Be careful not to miss it.

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