

May 22, 2008

Dear Friend,

As a follow-up to our March newsletter, in which we discussed a lecture we attended given by Jeremy Siegel, it seemed appropriate to submit a book review of the most recent edition of his book, *Stocks for the Long Run*. Professor Siegel originally wrote this book 13 years ago and it is now in its fourth edition. Professor Siegel initially wrote the book with two goals in mind: to document the rates of returns on the major classes of financial assets over the last 200 years and to offer strategies that maximize long-term portfolio growth. The fourth edition updates all data from the third edition and adds chapters on behavioral finance, globalization, and exchange-traded funds.

Among the many interesting topics covered, one of the more unique areas of Siegel's research has to do with the persistency of stock returns over time. Much research has been done on the historic rates of return for various asset classes such as stocks, bonds, and treasury bills, but most data for this research has been limited to the last 80 years or so from the period beginning in 1926. Through extended research, Professor Siegel has extrapolated data for these same asset classes as far back as 1802.

The widely recognized and publicized data for stock rates of return since 1926 are right around 10% annually, bonds are approximately 5%, and treasury bills 3%. What Siegel demonstrates is that these same returns have persisted, not only since 1926, but as far back as 1802. His research shows that stocks have produced a 7% annualized rate of return, after inflation. When the historical inflation rate of 3% is included, then stocks have earned the familiar 10% annually.

With this nearly 200-year time horizon in mind, Professor Siegel then begins to look at holding periods ranging from 1-30 years for stocks and bonds. He observes the worst case and best case scenarios for both stocks and bonds for potential holding periods of up to 30 years. For periods of five years or less, the observation is that stocks are riskier than bonds. However, at five years stocks are only slightly riskier than bonds after inflation. Extending the holding period to ten years or more, he concludes that stocks are safer than bonds when measured by long term purchasing power, or the ability of our portfolios to keep up with inflation.

Another topic of interest in *Stocks for the Long Run* is the psychology of investing. Many in the finance profession are beginning to realize that managing a client's emotions and psychological tendencies is a growing part of a financial advisor's obligation to his clients. It is natural for investors to feel confident about investing when the stock market is up and invest money during these times (buying high) and to become nervous about having money in the stock market when the market is down (selling low). This, obviously, defeats the purpose for investing in the first place.

According to Professor Siegel, to be a successful long-term investor, you must set up rules to keep your investments on track. To do this, you should decide on a desired asset allocation and stick to it. Some feel they can develop an asset allocation model themselves while others achieve this with an investment advisor. Whatever the case, stick to your rules and know that the basic factors responsible for portfolio returns change very little, even though the market fluctuates on a daily basis.

Though this book is written with an academic mindset, it really is not a difficult book to comprehend. There are many more topics worth exploring in this book and this paper really just touches on a few highlights.

#### ***About the Author***

Jeremy Siegel is a professor of finance at the Wharton School of the University of Pennsylvania. Professor Siegel received his PhD from M.I.T. and has been hailed by *Business Week* as the top business school professor in the country. He has written and lectured extensively about the economy, is regularly courted by Wall Street firms as a consultant and has appeared on CNBC, PBS, *Wall Street Week*, and NPR.

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