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Book Review

Triumph of the Optimists

by Elroy Dimson, PhD, Paul Marsh, PhD & Mike Staunton, PhD

This book is about the long-running performance of equities, bonds, bills, inflation, and exchange rates around the world over the 101 year period from 1900-2000. The countries included: Japan, United Kingdom, France, Germany, Canada, Italy, Netherlands, Switzerland, Hong Kong, Australia, Spain, Taiwan, Sweden, Finland, China, S. Korea, S. Africa., Brazil, Greece, Belgium, Denmark, Ireland, and, of course, the United States. In the year 2000, at the time this book was written, the total market capitalization of these countries equaled just over $34 trillion in value, representing 88% of the world's market capitalization.

One of the more interesting subjects the authors discuss, is that there is an equity risk premium in all of the countries researched. The equity risk premium is the difference between the long-term average return of equities and the return of risk-free investments, such as treasury bills in the U.S. They found that the annualized equity risk premium for the United States was 5.8% and that the average for all sixteen countries was 5%. Of the sixteen countries, the United States equity risk premium was the 6th highest. The story is similar relative to long term bonds in the sample period of this research. The equity risk premium for the U.S. relative to bonds was 5%, and the average of the sixteen developed countries was 4.5%.

Why is the equity risk premium important? The authors point out that investors, in order to compensate for additional risk, require additional compensation as a reward for the additional risk. The equity risk premium, while widely publicized in the United States, apparently is remarkably consistent on an international basis as well.

The authors also emphasize the importance of international diversification. Countries in this study experienced a wide assortment of events and challenges with respect to their individual countries and economies. They conclude that since markets act differently at different times, a portfolio that is diversified amongst these countries experiences lower portfolio volatility. Amazingly, included in the countries in this research are Germany and Japan. Germany's stock market, even after the loss of two World Wars, which nearly led to the total collapse of its economy, averaged a 9.7% rate of return. Japan's market turned in a 12.5% return. It is interesting to compare this to the United States market that dealt a 10.1% return during the same period!

This book is a good read for investors looking for validation of the existence of an equity premium. Not only does Triumph of the Optimists, like other finance research, prove the existence of the premium in the United States historically, but it also proves the existence in each of the sixteen most developed countries in the world. One would have trouble finding that coincidental. This book has a lot of data and is written by academics, but is relatively easy to understand. As there were not a lot of these books originally published, it can be an expensive acquisition, at least for a new copy.

About the Authors

All three authors are at the London Business School. Elroy Dimson is Professor of Finance, Paul Marsh is Esmeé Fairbairn Professor of Finance, and Mike Staunton is Director of the London Share Price Database.