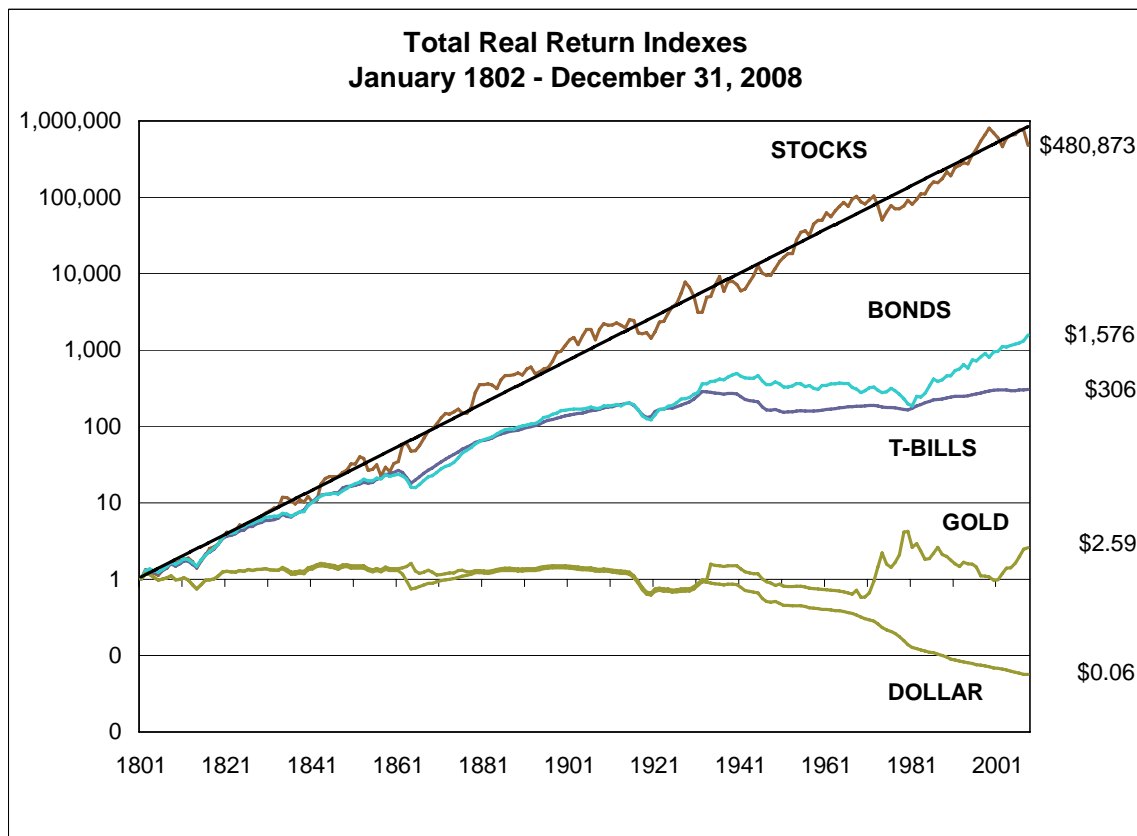


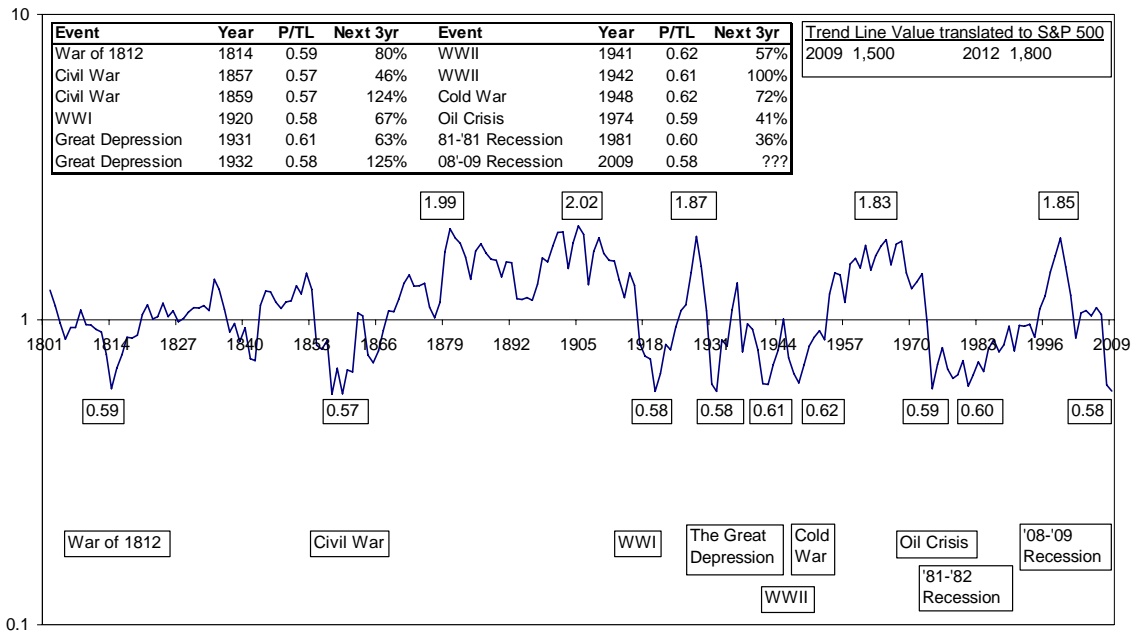
Note

The conventional view of stocks is that while they provide the greatest return potential, they are also the most volatile asset class and that stock price movements are random. While true in the short run, these latter two conclusions become false when time intervals lengthen. Stocks are in fact THE most stable asset class in the long run and stock prices at the extremes have ALWAYS stayed within the same bounds. For most who study the stock market, including us until recently, data is examined back to the 1920s. Dr. Jeremy Siegel, the renowned Wharton Finance professor, has gone through the laborious task of extending the data series back to 1801. This extra century-plus may seem like ancient, meaningless history, but the following will likely change that view.



The chart above depicts inflation-adjusted (“real”) returns for major asset classes for the past 200+ years. While the stock return advantage is obvious, the more interesting and surprising aspect of this chart is the stability of stocks over time. For as far back as can be measured, stocks have advanced at a rate of 6.5% (the slope of the trend line) plus inflation, and the fact that a ruler can be used to draw the trend line is truly remarkable. By contrast, all the other major asset classes have long periods of hot and cold returns making them clearly less stable and reliable relative to stocks.

Siegel Stock Price to Trend Line Ratio



Relating stock price to the trend line produces the arguably even more fascinating chart above. This chart provides compelling evidence of order and a system in long-term equilibrium in contrast to the prevailing view of random, chaotic price movements. There are well-defined limits as to how hyped stocks become just as there are limits as to how depressed they become. It also puts into perspective the magnitude of the event we're enduring, as it joins a list that includes the Civil War, The Great Depression and six other momentous calamities of the past 200 years.

It also makes an overwhelmingly Bullish case for what we can expect ahead, as this chart reveals the strong mean-reversion tendencies of stocks when a point of extreme depression is reached. In fact, it takes a subsequent calamity to keep stock prices from quickly returning toward the trend line. To put the present market level into perspective, the S&P 500 at 1,500 represents the current trend line value with 1,800 the approximate value three years hence. From the depths of despair three months ago, returning to these valuation levels quickly was hard to imagine. A recovery of this magnitude is made more believable by the market's impressive bounce off the bottom since then, as we're already well on our way.

Keep the faith!

Lowell