Thirty Years of Hurt

It's not just the last decade that's been harsh on stocks. A report from Jim Bianco's eponymous research company calculates that for the past thirty years treasury bonds have outperformed stocks. It's the first thirty year period since 1861 that this has happened according to research on the topic by Jeremy Siegel.

What could be safer than to bet on a continuation of a thirty year trend? Most of the people working on Wall Street have lived the majority of their careers during a time when safe, stodgy investments have been the place to be – though it should be added that the relatively long duration of thirty year bonds makes their price moves more perky than shorter maturities. But the very success of bond investing makes it that much harder to repeat the performance. Just as stocks had impossibly high P/E ratios in the late 90s as the internet bubble climaxed, ten-year treasury notes yielding 2.2% can only return 2.2% over the next ten years. Thirty year bonds returned 11.5% over the past thirty – the yield on thirty year bonds thirty years ago was 14.68% (according to the Federal Reserve's H-15 report) which accounts for their subsequent return. Today's thirty year bond yields 3.25%. As mysterious as is the Math of fixed income to some, even Bernie Madoff couldn't conjure up past returns out of today's yields.

No doubt for some time to come bonds will be the beneficiary of investors. The world remains a financially risky place, and the latest EU crisis measures increasingly appear to be short of what's needed. Wilbur Ross was on CNBC this morning noting that a 50% writedown in all EU peripheral sovereign debt (i.e. the GIPSI countries) would require an additional €400BN in bank capital compared with the EBA's current stress-test estimate of €100BN (of which €30BN is for Greek banks). Other analysts are increasingly finding fault with the absence of detail in the plan. There continues to be plenty for investors

to worry about. And yet, stocks don't require much dividend growth to outdeliver bonds. $20 in 2% yielding stocks with 4% growth provides the same return as $100 in 2% yielding ten year treasuries, leaving $80 to be held in cash or invested elsewhere. Stocks have had a great October and cheaper entry will be available. But the math is compelling.

There have been many times when the ultimate high in the bond market could have occurred – however, one can be certain that past performance will not predict future returns. One can be reasonably sure that future returns will be very low single digits. And there's a decent chance that today's bond investors will lose money. Safety comes with a price.