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Wenning Investments, LLC

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Bonds Outperformed Stocks Over Past Decade

It's been widely accepted that over the long-term, stocks will outperform bonds. Is it time to reconsider?

Bonds are generally meant to reduce risk, produce income and provide diversification. Stocks are where the money is.

However, as the last decade has shown, that's not necessarily the case. During the past 10 years, 10-year U.S. Treasury bonds have returned 7.06%, while stocks in the S&P 500 have brought investors a return of just 2.92%.

And the past 10 years may not be an anomaly. Consider this analysis by Robert Arnott in [*Index Universe*](#): "It's now well-known that stocks have produced negative returns for just over a decade. Real returns for capitalization-weighted U.S. indexes, like the S&P 500 Index, are now negative over any span starting 1997 or later.

"People fret about our 'lost decade' for stocks, with good reason, but they underestimate the carnage. Even this simple real return analysis ignores our opportunity cost. Starting any time we choose from 1979 through 2008, the investor in 20-year Treasuries (consistently rolling to the nearest 20-year bond and reinvesting income) beats the S&P 500 investor. In fact, from the end of February 1969 through February 2009, despite the grim bond collapse of the 1970s, our 20-year bond investors win by a nose. We're now looking at a lost 40 years!"

It's not like the "lost decade" has turned into the lost four decades, but - as an asset class - stocks overall have not performed with the exuberance expected. When stocks perform well, they often perform exceptionally well for a long period. When they perform poorly, they often do so for an

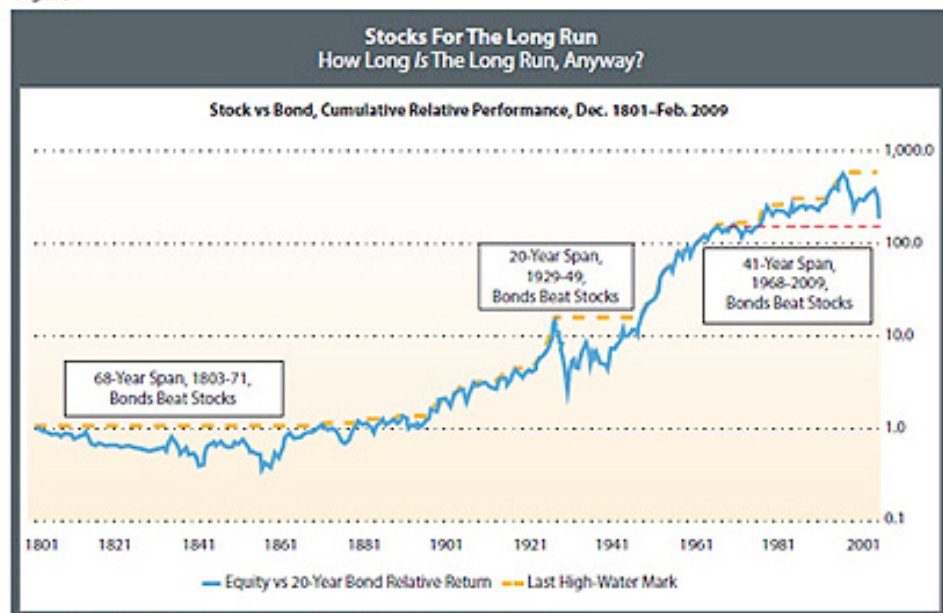
extended period.

This is, of course, a solid reason why the traditional "buy-and-hold" investment approach is so risky long term.

Bonds may not have returned consistent double-digit returns either, but by outperforming stocks over the past decade, they have provided a reminder that they can play an important role in every investor's portfolio.

Of course, keep in mind that bonds will not outperform stocks forever. Investors should not put all of their money in bonds any more than they should put all of their money in stocks. Diversification is important for managing risk.

Figure 1



Source: Standard & Poor's, Ibbotson Associates, Cowles Commission and Schwert

Bonds often outperform stocks over long periods.

Bond Performance is Cyclical

Arnott's article - written in 2009, but still relevant - found that when bonds have beaten stocks, historically they have beat them over fairly long periods of time.

As shown in the graph above, going back to the beginning of the 19th century, bond performance beat stock performance for a 68-year span from 1803 to 1871, a period that included the Civil War. Bonds beat stocks again during the 20-year period of 1929 to 1949, which, of course, included the stock market crash, The Great Depression and World War II.

Finally, bonds beat stocks over the final 41 years of Arnott's study, from 1968 to 2009. If the study were extended through 2011, the results would still hold, in spite of the resurgence of the stock market that began in March 2009.

During the cycles in which bonds beat stocks, stocks generally performed poorly, but such periods were followed by strong equity performance. Will bonds continue to outperform stocks or are they ending another cycle?

That's an important question. The spans in which bonds beat stocks make up the majority of years included in the study, yet overall, stocks still outperformed bonds by an average of [2.5% per year](#).

Looking Forward

When interest rates and inflation rates rise, bond prices usually fall.

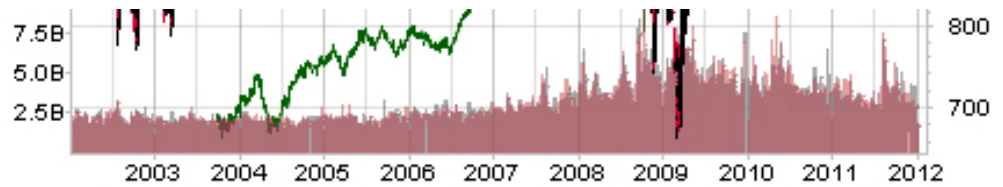
Some believe the current unprecedented level of government spending will boost inflation, which would have a negative impact on bonds. However, a high rate of inflation would likely have a negative impact on stocks, too.

"Bonds may or may not be a great place to be going forward, particularly Treasuries, once a reduced fear factor allows people to assume more credit risk," according to [Seeking Alpha](#), "or when China and other major buyers lower bids to obtain the rates they feel they need for the long-term."

Conversely, with Baby Boomers approaching retirement, asset preservation is trumping asset appreciation, and they are likely to move an increasing amount of their assets into bonds. Of course, many left the market after the 2008 crash and have not returned or are holding a smaller percentage of their assets in stocks.

Wenning Investments will remain diversified, but will continually monitor both asset classes and will shift a greater allocation into stocks when signs point to a rising market.





Barclay's iShares Bond Fund, an aggregate of the U.S. bond market, shows that bonds have been outperforming the S&P 500 stock index.

2011's Most Profitable Stock Market - Venezuela!?!?!

Let's hear it for Venezuela, Botswana and Jamaica.

If you had invested all of your money into a portfolio or index representing all of Venezuela's stocks at the beginning of 2011, by October 17, you would have enjoyed a return of 53.23%, according to [Wall Street Cheat Sheet](#).

Country Stock Market YTD Performance

Country	YTD % Chg	Country	YTD % Chg	Country	YTD % Chg	Country	YTD % Chg
Venezuela	53.23	Thailand	-7.45	Singapore	-13.98	Chile	-18.75
Botswana	11.04	Namibia	-7.71	Japan	-14.48	Estonia	-18.77
Jamaica	8.57	Saudi Arabia	-7.79	Vietnam	-14.48	Peru	-19.22
Ecuador	0.86	Morocco	-8.64	Belgium	-14.56	Italy	-19.25
Bermuda	-0.13	Abu Dhabi (UAE)	-8.90	Netherlands	-14.71	Hong Kong	-19.68
New Zealand	-0.20	Spain	-8.96	Romania	-15.03	Bahrain	-19.71
Pakistan	-0.29	Mexico	-9.57	Dubai UAE	-15.08	Nigeria	-19.78
Indonesia	-1.05	Ireland	-9.72	France	-15.43	Israel	-19.82
Philippines	-1.14	Canada	-10.13	Kuwait	-15.64	Brazil	-20.60
Sri Lanka	-1.30	Turkey	-10.16	Poland	-16.16	Argentina	-23.07
Iceland	-1.73	Switzerland	-10.49	Serbia	-16.38	Czech Rep.	-23.59
United States	-2.63	South Korea	-10.51	India	-16.71	Denmark	-23.67
Latvia	-2.74	Australia	-11.37	Sweden	-17.24	Kenya	-26.06
South Africa	-3.10	Portugal	-12.69	Lebanon	-17.29	Finland	-26.14
Qatar	-3.28	China	-13.41	Lithuania	-17.37	Luxembourg	-26.83
Mauritius	-4.26	Colombia	-13.52	Malta	-17.48	Austria	-27.23
Malaysia	-5.04	Croatia	-13.62	Russia	-17.71	Bangladesh	-32.83
Slovakia	-6.39	Germany	-13.70	Taiwan	-17.99	Greece	-45.15
Bulgaria	-6.77	Norway	-13.82	Hungary	-18.18	Ukraine	-46.93
Britain	-7.35			Oman	-18.34		

G7 Countries

BRICs

Of the 78 countries whose market performance was tracked, only four had positive returns as of that date - Botswana was a distant second, with a return of 11.04%, while Jamaica's market recorded a return of 8.57%.

Ecuador was barely positive, with a return of 0.86%.

The United States ranked 12th, with a loss of 2.63% as of Oct. 17, but, as the *Cheat Sheet* noted, it was "second among countries 99% of people would actually invest in (Indonesia continues to be the star of the past three years)."

The U.S. finished 2011 with a gain of 5.2%, according to the [International Business Times](#), which ranks second only to Germany's 5.9% gain among the countries tracked.

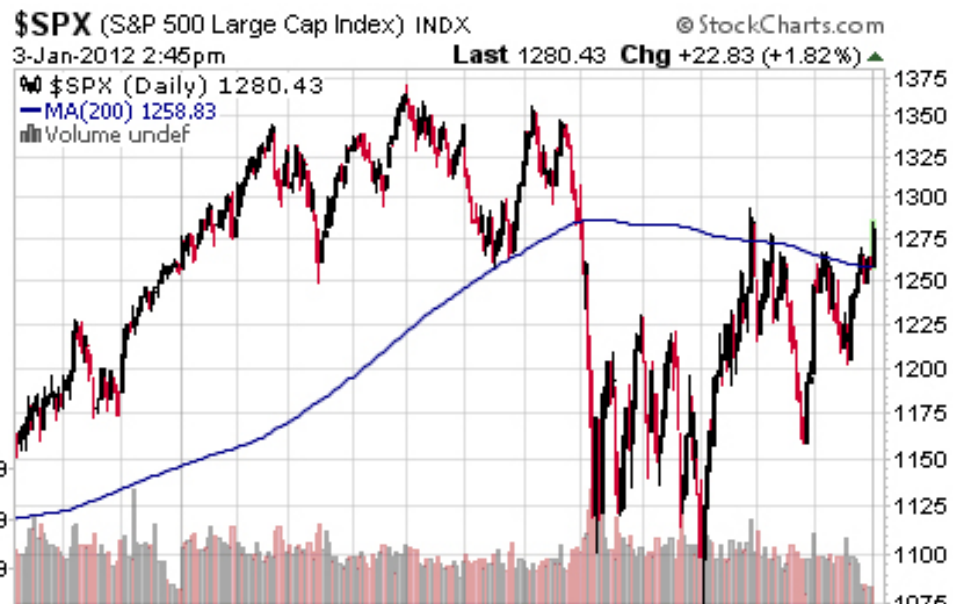
In the U.S., blue chip stocks generally outperformed small-cap stocks. The Dow Jones Industrial Average finished up 5.53%, while the S&P 500 was flat for the year and the Russell 2000 was down 5.48%, [T. Rowe Price](#) reported.

Among other countries tracked by the *Cheat Sheet*, Italy showed a 19.25% loss for the year as of October 17. That's the lowest return among G7 countries.

Greece, not surprisingly, finished with a return of -45.15%. It could have been worst. One country, Ukraine, finished with a lower return than Greece at -46.93%.

Before you start investing in Venezuela, keep in mind that these returns are all relative. President Hugo Chávez has not found capitalism - it's just that his country started at such a low level, it didn't take much to produce a high return.

Ditto Botswana and Jamaica. Not surprisingly, given the sovereign debt crisis, virtually all of Europe fared poorly.





The S&P 500 was flat for 2011. The blue line represents the 200-day moving average.

Definitions: Not All Bonds Are Created Equal

Lumping all bonds together to track returns for the asset class, as we've done above, can be dangerous, as one bond can be as different from another as a penny stock is from a blue chip stock.

Before considering where to invest, it's important to have a general understanding of the different types of bonds.

Bonds are issued by government agencies and corporations, typically to finance capital projects. They are "fixed-income" securities. Their value fluctuates, but they also pay income on a regular basis and the income rate stays the same until the bond matures.

Bonds are rated by credit-rating agencies. Those with a rating of "BB" or lower are referred to as **junk bonds**. Junk bonds pay a higher "yield" than bonds with a higher rating, but they also carry a higher risk of defaulting.

Government bonds, which are issued to finance government projects, do not offer high returns, but they are low-risk investments and provide tax advantages, such as exemption from state and municipal taxes. Examples include U.S. Treasuries and municipal bonds.

U.S. Treasuries include short-term Treasury bills and medium-term Treasury notes. They are currently bearish, given today's historically low interest rates and historically high federal debt. They are considered to be the least-risky of all bonds, but European sovereign debt was previously considered to be low risk, too.

Municipal bonds, or "munis," are used to finance local and state projects. They are currently performing well, probably in anticipation of a Federal bailout of states and in anticipation of tax hikes.

Corporate bonds can provide higher returns, but they are riskier and do not provide tax advantages.

Mortgage-backed securities (MBS) are another type of bond, but one that proved to be far riskier than anticipated, becoming the central cause of the financial crisis of recent years.

The **yield curve**, which is reported daily in financial newspapers, illustrates the difference between the yield of bonds with different maturity periods. The steeper the yield curve, the greater the difference between the yield of short-term and long-term bonds. If it is steep, long-term bonds are probably

the better investment. If it is flat, you will not receive a premium for investing your money long-term, so it is best to stick with short-term bonds.

Laddering, or purchasing bonds with different maturities, reduces interest rate risk. To build a laddered portfolio, investors would purchase bonds that mature throughout a set investment period. For example, if the investment period is 10 years, investors could buy five bonds with maturity periods of two, four, six, eight and 10 years.

When the first bond matures, we would replace it with a 10-year bond, maintaining the ladder by adding another rung at the end. By laddering your portfolio, you are spreading your risk over not only different time periods, but different interest rates.

Barbell strategy. Using a "barbell," the investor concentrates bond holdings at both ends of the spectrum. A high percentage of investments goes into short-term bonds, typically with maturities of a year or less, and a similar percentage goes into long-term bonds, typically with maturities of 20 to 30 years.

A barbell strategy is effective when there is uncertainty about whether interest rates are heading up or down. If they're heading down, long bonds are a good investment. If they're heading up, shorter maturities are better. Concentrating investments on both ends of the spectrum lowers your risk, whether rates go up or down.

Keep in Touch

Have an idea for a future issue of *Wenning Advice*? Are you interested in active investing or would you like to refer a friend who may be interested?

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