

October 21, 2008

Economic Indicators Canada

	Dec. 2007	Sept. 2008	
GDP ⁽¹⁾	2.7	1.2 ⁽³⁾	↘
CPI ⁽¹⁾	2.4	3.4 ⁽⁴⁾	↗
Unemployment	5.9	6.1	↗

United States

	Dec. 2007	Sept. 2008	
GDP ⁽¹⁾	2.2	2.1 ⁽²⁾	↘
CPI ⁽¹⁾	4.1	4.9	↗
Unemployment	5.0	6.1	↗

- (1) Year-over-year % variation
 (2) June 2008 (3) July 2008
 (4) August 2008

Sources: Statistics Canada, U.S. Dept. of Commerce, U.S. Dept. of Labor Statistics.

Equity Indices

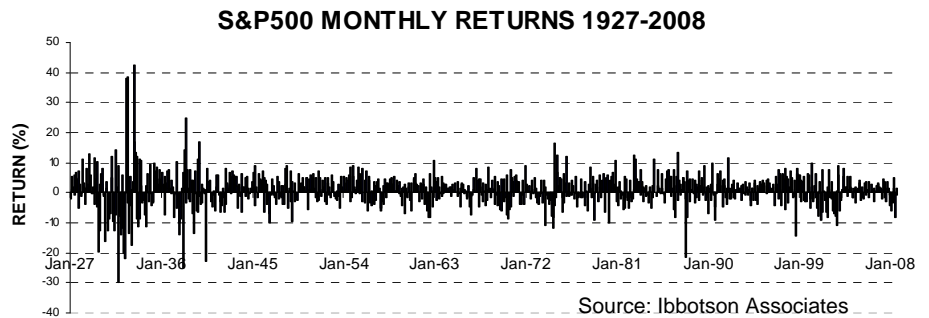
% Change	2008 in local currency	2008 in C\$	
S&P/TSX	-26.3	-26.3	↘
S&P 500	-32.9	-19.2	↘
Russell 2000	-28.6	-14.0	↘
Nikkei	-41.2	-22.2	↘
S&P 350 Europe	-38.4	-32.2	↘

THE ANATOMY OF SAVING AND INVESTING – PART 3

The first part of this series demonstrated how decisions about saving and portfolio risk are intertwined. Part 2 addressed how the bond market compensates for various degrees of risk. This month, we apply the lessons learned from the bond market, in order to gauge what kind of returns can reasonably be expected from equity investments.

Stocks have one thing in common with bonds: they are a property claim on a certain amount of cash flows (companies' earnings per share). But because they do not pay a contractual interest rate, their expected return is not readily seen. In addition, short-term stock returns are volatile, and therefore don't provide any insight about future returns.

As an example, the graph below depicts the monthly returns of the S&P500 since 1927.



In contrast, very-long-term averages tell a different story: asset-class returns are consistent with their risk level, as demonstrated by the following table:

U.S. Asset Class Returns 1927-2008

Inflation	3.16%
Treasury Bills	3.73%
Long-term Government Bonds	5.39%
Long-term Corporate Bonds	5.73%
Large Cap Equity	10.12%
Value Equity	11.53%
Small Cap Equity	12.29%

Source: Ibbotson Associates

In short, U.S. Large Cap Equities have produced a compound return of roughly 7% after inflation, while the riskier Value and Small Cap Equities delivered a premium above that level. Moreover, the empirical evidence from international markets is consistent with the U.S. data. But a note of caution must be sounded here: most academics consider that, in the coming years, Large Cap Equity returns will likely be more modest, ranging on average between 4% and 6% above inflation.

Next month, we will review the unpleasant aspect of investing: risk.

Raymond Kerzérho, Director of Research

