

# News Release

FOR IMMEDIATE RELEASE  
11:30 AM CDT December 21, 2009

## **The Happiest Day of the Year and Better Equity Returns Ahead!**

December 21 - winter's first day - is the happiest day of the year and I can prove it. You see a calendar year has 365 days. It is comprised of two consecutive 182.5 day periods. For the past 182.5 days, beginning with the Summer Solstice, the sun has been making its way from the Northern Hemisphere to the Southern. With the sun's June-time departure, our Northern Hemisphere days have been getting short and temperatures cold. Certainly, minimal sunlight and cold are no reasons to celebrate. On that, we all can agree.

However, today at 5:47 UTC the Winter Solstice began. In other words, it's time to get happy for the sun has turned around and is coming back to where it belongs! Increasing amounts of sun and warm weather ahead for the next 182.5 days, now those are

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quality reasons to celebrate. And that is why we recognize this day, December 21, 2009 as the happiest of the year.

Credit for this reasoning is actually due to my Dad who pointed out all this out a long time ago. You see, even though Dad lived in the Middle West most of his life, he never really embraced winter's full beauty...if you know what I mean.

Interestingly, a similar line of thinking can be used to forecast equity market returns for the next 10 years. In today's Wall Street Journal, writer Tom Lauricella points out in *For Stocks, the Worst Decade Ever* we are set to close the books on one of the worst 10-year performance periods in history. The stock market will record a -0.5% average annual return over the past 10 years ending 12/31/2009. Pretty much every asset class you can name bettered stock's dismal return. Equity market numbers are worse after adjusting for inflation. The average annual real return over the past 10 years is -3.15%!

Earlier this year, Jeremy Siegel of Wisdom Tree completed a study of equity market returns. His work gave a history of real returns between 1871 and 2008. To develop our Brady Investment Counsel market forecast for the next 10 years we will borrow Prof. Siegel's 20-year real return findings; plus, employ a bit of my Dad's winter celebration logic.

It takes two consecutive 10-year periods to make one 20-year period. We know -3.15% was the most recent 10-year real return for stocks. In addition, thanks to Prof. Siegel we know the worst 20-year real return ever recorded by the equity market is 1.04% (That's right positive 1.04%. Equity investors have never lost money in real terms over a 20-yr period.) We also know the bottom quartile inflation-adjusted return is 4.31%, the median is 6.85% and the top quartile is 8.55%. The best 20-year real return ever earned by the equity market is 12.63%.

Since we know the equity market's return over the past 10 years and the range of 20-year returns over the market's history, we can solve for the next 10 years to develop our long-term forecast. If between 1999 and 2019 the market were to tie its worst 20-year real return ever (1.04%), it must gain at a 5.4% annual real rate over the next 10 years to do so. In other words if you combine the -3.15% real return earned over the past 10 years with a 5.4% annual return for the next 10, then the 1999-2019, 20-year compounded real return would equal 1.04%.

The return numbers get even better as you move up Siegel's quartiles. If between 1999 and 2019 the stock market will match the 1871-2008, 4.32% bottom quartile 20-year return, then over the next 10 years the equity market will gain at a 12.4% annual real rate. 12.4% would be solidly in the top quartile of 10-year real returns!

No one is forecasting the market will produce a top quartile return over the next 10 years. But isn't that a required element for achieving top-notch returns? Nobody believes it will happen so they are not paying for it.

Second, don't be fooled by folks saying the market is expensive based on its trailing 28X P/E multiple. The stock market is the world's greatest discounting machine. It looks forward, not back. Trailing earnings do not matter. Only future earnings do.

Our Brady Investment Counsel market valuation work is centered on normalized earnings potential. It currently shows U.S. companies are under achieving normalized potential. This should come as no surprise given the financial collapse and challenging global business environment over the past year or two. However, as the global economy improves so will earnings - only at a much faster rate.

The market is not giving credit for earnings potential; thus, stocks are undervalued. ICI data illustrate investors are currently putting new money in everything but U.S. stocks.

So be optimistic, days are getting bright and will eventually warm. In addition, the US equity market is undervalued. It is

very reasonable for investors to expect positive and impressive real returns over the coming decade.

Merry Christmas!

David P. Brady, CFA, CIC, President

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