



Economic Insights

Ask the Economist

with Milton Ezrati

HISTORY IS ON THE SIDE OF THE BULLS – September 23, 2002

by Milton Ezrati.

The duration and extent of this bear market has prompted a lot of historical comparisons: with the troubled 1970s, with the years leading up to America's entry into World War II, even with the Great Depression of the 1930s. While most of these comparisons tend to inspire fear, a hard look at the data should do the opposite. The history shows, in fact, the present situation as almost certainly a buying opportunity.

Lord Abnett Regional Manager Hayden Fisher has suggested useful perspective for historical comparisons. Given the market decline since 2000, he suggests, we can test projections by seeing what they imply for the average growth of this first decade of the 21st century. Then we can assess how reasonable they are by comparing that implied growth against the historic record.

The table below depicts rolling ten-year returns for the market from 1926 through 2001, all stated at compounded annual rates. Thus, the first entry on the table shows that the market returned 5.86 percent a year on average during the ten-year stretch from 1926 through 1935. The second entry drops the return for 1926, adds that of 1936, and recalculates the average annual return for this next ten-years. The statistics continue in this way through 2001. The worst ten-year experience occurred between 1928 and 1939, when the market fell by 0.89 percent per year. Clearly, the strong positive returns in 1933 and 1935 did much to offset the steep declines between 1929 and 1932. The best ten-year experience occurred between 1949 and 1958, when the market rose at a 20.06 percent annual rate. The average return for the entire period 1926-2001 came to 10.7 percent per year. The average return for the post World War II period came to 12.4 percent per year.

It is remarkable, given the periodic difficulties during these times, how seldom the market fell over a ten-year stretch. Only twice did it produce a negative return, during the 1929-38 and 1930-39 periods. Only five times did it produce a return of less than 3 percent, a criteria that adds the experiences of 1928-37, 1931-40, and 1965-74. Only nine times did the market return less than 5 percent, a criteria that adds the experiences of 1937-46, 1966-75, 1968-77, and 1969-78. All the rest of this time, the market, taken in ten-year internals, provided considerably more return than most people think of today as likely for this first decade of the 21st century.

With the S&P already down 36 percent so far in this decade, this history argues strenuously against today's popular pessimism and certainly any forecast for a more prolonged decline. In fact, this long and detailed record says that future declines are extremely unlikely. If, for example, the market were to go nowhere for the rest of the decade, a popular forecast among many who compare this time to the 1970s, the ten-year return would amount to an average annual drop of 4.4 percent. That result would be extreme to say the least in light of history. It would almost quintuple the record drop of 0.89 percent annually set in the great depression. Many risks, however, confront the market today; it is highly unlikely that events will turn out to be worse than the Great Depression, especially since the U. S. economy, with an unemployment rate still below 6 percent of the workforce, shows no sign of even coming near a duplication of that difficult time. Yet, that is the implication of this popular bear outlook. Even if the market were to equal the experience of the Great Depression, the decline to date would require that it rise from here at over a 5 percent annual rate, a welcome event given today's depressed mood. Such returns would certainly hold greater appeal than cash and even the current yield on longer-term treasures. Yet, even this comparatively pleasant outlook is probably unreasonably pessimistic, since it effectively looks for a rerun of the Great Depression.

Following are the implications for the rest of this decade based on other possible historical scenarios, both good and bad:

- If the market in this first decade of the 21st century were to duplicate the worst ten-year performance since the end of the Second World War, the 1.24 average annual percent return between 1965 and 1974, it would have to produce annual returns of 8.2 percent during the rest of the decade.
- If the market were to duplicate its worst performance since 1970, 5.86 percent between 1970 and 1979, it would have to rise at a 15 percent annual rate for the rest of the decade.
- For the market in this decade to produce its average ten-year performance of the entire 76-year period, it would have to return 22.4 percent annually for the next seven-plus years.
- For the index to duplicate the average ten-year return of the post World War II period, it would have to rise at a 25 percent annual rate for the rest of this decade.

Obviously, none of these scenarios constitutes a forecast. They do, however, put today's pessimism into perspective. If the S&P 500 returns less than 5 percent a year from now to the end of the decade, it will produce the worst ten-year stretch of its history, an event that is hardly likely. If its annual return for the next seven-plus years falls short of 15 percent, this first decade of the 21st century will fall well short of any ten-year stretch of the past 30-plus years. We believe the implication is that conditions are likely to improve going forward. After almost three full years of market pain, history now is poised on the side of the bulls.

TOTAL RETURN, LARGE-CAPITALIZATION STOCKS*
(Ten-year intervals, expressed at average annual rates)

1926-35:	5.86	1952-61:	16.43	1978-87:	15.26
1927-36:	7.81	1953-62:	13.44	1979-88:	16.33
1928-37:	0.02	1954-63:	15.91	1980-89:	17.55
1929-38:	-0.89	1955-64:	12.82	1981-90:	13.93
1930-39:	-0.05	1956-65:	11.06	1982-91:	17.59
1931-40:	1.80	1957-66:	9.20	1983-92:	16.19
1932-41:	6.43	1958-67:	12.85	1984-93:	14.94
1933-42:	9.35	1959-68:	10.00	1985-94:	14.40
1934-43:	7.17	1960-69:	7.81	1986-95:	14.84
1935-44:	9.28	1961-70:	8.18	1987-96:	15.28
1936-45:	8.42	1962-71:	7.06	1988-97:	18.05
1937-46:	4.41	1963-72:	9.93	1989-98:	19.19
1938-47:	9.62	1964-73:	6.00	1990-99:	18.20
1939-48:	7.26	1965-74:	1.24	1991-00:	17.46
1940-49:	9.17	1966-75:	3.27	1992-01:	12.93
1941-50:	13.38	1967-76:	6.63		
1942-51:	17.28	1968-77:	3.59	Avg. Annual Percent Return:	

1943-52:	17.09	1969-78:	3.16		
1944-53:	14.31	1970-79:	5.86	1926-01:	10.7
1945-54:	17.12	1971-80:	8.44	1945-01:	12.4
1946-55:	16.69	1972-81:	6.47	1970-01:	12.0
1947-56:	18.43	1973-82:	6.68	1980-01:	15.0
1948-57:	16.44	1974-83:	10.61	1990-01:	12.8
1949-58:	20.06	1975-84:	14.76		
1950-59:	19.35	1976-85:	14.33		
1951-60:	16.16	1977-86:	13.82		

Source: Ibbotson Associates

* This chart represents historical data only and does not reflect any investments in Lord Abbett funds or any other investments.

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Milton Ezrati, Senior Economic Strategist for Lord, Abbett & Co., has been widely published in a wide variety of newspapers, magazines, and scholarly journals, including The New York Times, The Financial Times, The Asian Wall Street Journal, The Christian Science Monitor and Foreign Affairs, on a broad spectrum of investment management topics. Prior to joining Lord Abbett, Mr. Ezrati was senior vice president and head of investing in the Americas for Nomura Asset Management where he helped direct investment strategies for both equity and fixed-income investment management.

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