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by Austin Lemoine

A long, slow comeback for stocks?

For those who have incurred losses in this year's stock-market debacle, this article is for you.

Is the worst over? It's too soon to say for sure, but it's not too soon to survey your personal losses -- painful though it may be -- and institute some loss-mitigation measures.

"Asset allocation" is the mantra with financial journalists and commentators. That's well and good, but foremost is the drop in value of your portfolio -- and consequent impact on your personal financial goals.

There's a new-old math around: "Bear-market arithmetic." To whit: A percentage decrease in portfolio value is reversed only by a larger percentage increase. Reversing losses of 15, 20, 25, 40, 50, or 75 percent, requires gains in portfolio value of 18, 25, 34, 67, 100, or 300 percent (respectively). (That's because, for instance, a 25 percent loss from a $100 investment requires a 34 percent gain to get you back to $100 from the new base of $75.)

I'm not reciting those numbers to add insult to injury, but to underscore the need to have realistic expectations as you move forward.

For those able to save, some losses can be offset by saving more. Saving is much more under your control than market fluctuations. But saving more does require wherewithal and enough time to work, and the person approaching retirement who just had a big hit in their stock portfolio is unlikely to have that alternative. But given time, even modest savings can produce impressive nest eggs.

Will future market gains offset losses? In time, yes. But how much time?

History shows that from 1880 through 2000 there were four periods when stock-market bubbles (in particular, price-to-earnings ratios) peaked: Those ended in June 1901, September 1929, January 1966, and March 2000. The 2000 rise was spectacular – only 1929 comes close, as Robert Shiller, professor of economics at Yale University, points out in his book, *Irrational Exuberance*.

But after 1901, 1929 and 1966 it took at least 20 years following each peak for the market to regain and surpass the highs of the bubble years. Until then, for instance, real (inflation-adjusted) returns on the S&P Composite Stock Price Index (including dividends) were mediocre at best. In the two decades after the peak of 1901, the average return was *minus* 0.2 percent; it was 0.4 percent after 1929; and just 1.9 percent after 1966. We don't know anything about the 2000 bubble's recovery period -- yet.

Let's see what investing $1,000 a year for 20 years at those post-bubble rates would produce, compared with a 7 percent real rate of return -- which Wall Street has told the American public it can rely on with a long-term stock investment program.

Under Wall Street's "7 percent solution," an investment of $1,000 a year would be worth $43,873 after 20 years. Using the "real experience" rates of 1.9, 0.4 and minus 0.2 percent, $1,000 invested annually would be worth $24,506, $20,861, and $19,962, respectively, at the end of 20 years.

Those latter rates of return are not a terrific boost toward recouping substantial losses and achieving financial goals. Wall Street's dictum that, "It's always a good time to buy stocks," didn't hold after those prior market peaks. During 60 years of the 20th century, stocks were arguably not the best financial market investments.

If history is a guide, a real return for stocks averaging 2 to 4 percent a year would be a realistic expectation for the first 10 to 20 years of this century.

"Two to four percent a year! No way! That's un-American," you say. And you might well be right.

However, a note of caution regarding future stock returns is again struck by examining the so-called "equity premium," the rate of excess return of stocks over bonds. (See our article "When happier days are here again" for a discussion of the equity-premium issue and references.)

If stocks produce lower returns, then we'll all have to save more to reach our goals. If a lower-return scenario seems credible to you, then perhaps your plans should be based on more conservative assumptions. After all, you might wind up by "saving too much" for your goal.

Should you invest differently or modify your allocation between stocks and bonds? Reliable answers to those questions can only be known in hindsight.

No one is saying stocks will return less than bonds. Many are saying that in the future, stocks may not deliver the returns we've been used to.

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