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Stocks may face a dreary decade ahead

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By Peter Brimelow & Edwin S. Rubenstein

Commentary: Stocks may face a dreary decade ahead

NEW YORK (MarketWatch) -- Every year or so, we chart the progress of the stock market in terms of its long-run "total return" trend. That's adding in capital gains and dividends, and adjusting for inflation.

Our charts are based on the work of Professor Jeremy Siegel of the University of Pennsylvania's Wharton School, author of the classic book, "Stocks For the Long-Run." See Siegel's Web site jeremysiegel.com for more information. (He doesn't always agree with our conclusions!)

Siegel's most famous finding: stocks have accumulated on average in real terms at a remarkably consistent 7% or so over the last two hundred years.

Shown on a log scale this consistent trend appears as a straight line.

Of course, you have to squint at the long-run chart to see movements that, when actually experienced, seem very dramatic. For that reason, we focus on stocks' movements around their long-term trend in just the last 10 years.

Note: The long term trendline slopes upward on this chart, because is drawn on an arithmetic rather than a log scale.

When we first looked at Siegel's numbers in the late 1990s, stocks were over 80% above the long-run total return trendline, about as high as they ever get. Stocks reached similar levels in 1928 and 1968 -- both years when the stock market was notoriously topping out.

Stocks did fall after 2000 (remember?) But they never got lower than a few points below trend. Then the post-election Bush bounce in 2004-2005 took stocks to some 7% above trend.

After that, stocks stalled. That means that this time last year, because of that relentlessly accumulating trendline, stocks were down to less than 1% above it. See Aug. 26, 2005 column.

Now it's even tighter: Stocks are just 0.1% below trend, to be exact.

And even that's still well above the levels usually seen at major bear market lows. In both 1931 and 1973, stocks got some 40% below trend.

In other words, an epochal but not unprecedented bull market high has not yet, unlike in every other case on record, been succeeded by a corresponding bear market low.

This may sound worrying. But of course the major market indexes we're used to watching don't literally have to fall 40%. Because the underlying total return trend rises at some 7% a year, the indexes can just move sideways.

How long? Well, adjusting just for dividends, if the Dow Jones Industrial Average moved sideways until 2019, that would be the equivalent of Siegel's broad, total-return measure of stocks getting 40% below trend.

That's a 19-year stagnation in total, quite comparable to the Dow 16-year stagnation after 1966.

On the bright side, if you assume inflation will be equal to the Dow's dividend yield, the stagnation will end in 2014.

Whoopee!

Obviously, Seigel's numbers reflect a very general truth. There's plenty of room for dramatic deviation within the long-term framework. Witness the Bush bounce.

But, overall, it's hard to see much upside energy in stocks right now.

Of course, that's about what we said when we first discussed Siegel's numbers. See April 16, 2003 column.

OK - the market's higher now. But it has still not exceeded 2000's peak. And its room to zoom is now much less.

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