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## Ten Years of Stock Market History

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We've certainly been on the path to recovery in the stock market, with the S&P 500 index having risen over 60% since the bottom of the market on March 9<sup>th</sup> of this year. But exactly how expensive are stocks at this point? Should we be concerned that we're forming a bubble similar to the situation back in 1999? Also, have we just experienced a lost decade, with a 0% increase in stocks over that period?

I mention 1999 since that's 10 years ago, and the Dow Industrial Average first reached 10,000 back then; now, 10 years later, we've again climbed above 10,000, after having plummeted to as low as 6,547 last March. So, as Paul Lim, senior editor for Money magazine wrote recently in the New York Times, it does seem like we've gone nowhere. But if you dig into the details, as he does, you'll see that energy stocks climbed 150% over the last 10 years; consumer staples stocks rose 65% and utility stocks were up 50%. That's far from a lost decade, I think you would agree. The worst performing sectors were technology, financial services, telecom and consumer discretionary stocks (which include auto makers).

In addition, foreign stocks did quite well over the last decade, rising almost 40%. So how well you did in the last 10 years really depends upon how diversified your portfolio was, including into bonds and cash. Clients who have been with me for the whole decade are up, as a group, almost 40%; in "normal" times it would be closer to 65%, but that's not bad considering what we've been through - - the recession of 2000 through 2002 followed by the global financial crisis of 2007 through 2009. Now that's a decade to remember (or should I say "forget").

Now that we've climbed up significantly out of the deep hole we were in last March, are we as precariously

poised as we were in 1999, with a price-to-earnings ratio of 41.4? The short answer is no, since we're now at only at a P/E of 20.08. This is a measure of expensiveness of stocks, so that means they're now half as expensive as 10 years ago. By the way, the long-term average for P/E is 16, so we're above average in terms of pricy-ness. Just so you know, the figures used here for P/E are based on 10-year average earnings, a conservative measure that smoothes out short-term swings in corporate profits.

Does this mean that we should feel comfortable with how high stocks are right now, based on the 50% discount they're trading at compared to 1999? My answer is no, since according to Lim, the P/E has risen a large 87% since this rally began in March. That's a lot historically, so now we must hope that the "E" in the ratio, i.e. corporate earnings, starts to increase, so that the overall P/E ratio begins to decline, as it has in the past during the second half of bull markets. The problem is that the consensus estimate for S&P 500 corporate earnings in the third quarter is for a 13.7% decline. So the hope is that early in 2010 we'll start to see earnings rising instead of falling.

If that does not happen, stocks will indeed start to look quite expensive, especially if the rally continues. P/E expansion can happen only so long before investors become nervous that history is about to repeat itself.

So that's why it's good we've been skimming profits for all clients every few months, keeping the proceeds stored in a safe bond fund. That strategy will continue to make sure we do not become over-exposed to expensive stocks.

Let me know if you'd like to discuss this situation and our strategy in more detail.