Asset Allocation

Stocks vs bonds over the past 100 years

By Elaine Loo, Associate Investment Advisor

In Aesop’s fable of The Tortoise and the Hare, slow and steady wins the race. But is that really how it works in life? When it comes to investing, slow and steady can be a recipe for near-certain losses. To illustrate this point, let’s look at stock and bond returns over the past 100 years.

Think of The Tortoise and the Hare as a story about asset allocation – of fixed income investments, which appreciate slowly and appear reliable; and of stocks, which can appreciate strongly and quickly, but appear risky. Which is your best bet? The answer depends on what kind of race you’re running.

The past 100 years have been wildly volatile: inflation, deflation, a deep depression, explosive growth, two World Wars, embargoes, assassinations and pandemics. We often forget how frightening things seemed at the time. Although the world may seem scary now, it’s likely that the period ahead won’t be all that different from at least some of the periods we’ve experienced in the past. History repeats itself. You just don’t know which part of the past you’re going to get! But by studying history, you can get a good feel of the range of possible outcomes going forward.

Data from the University of Chicago shows that, over the past 100 years, if you owned equal amounts of every U.S. stock excluding the smallest 20 percent, you would have enjoyed average annual growth of 11.5 percent, for an inflation-adjusted (real) return of 8.3 percent. Over the same period, fixed-income investments averaged 4.3 percent, or real returns of just 1.1 percent per year. So, the real returns from equities were nearly seven times higher than those of bonds. If you started with $100,000 in bonds, this would have grown by about $29,000 after 20 years using real returns. That same amount invested in stocks would have grown by $414,000, or 14 times as much!

Aren’t stocks much riskier than bonds? Yes and no. The stock market is volatile in the short term, making stocks seem risky. But if you invest for the longer term – more than 10 years – history shows that down markets have almost always been more than offset by up markets, giving reliable returns for stocks after inflation.

Inflation actually makes bonds riskier than stocks over the long term. The return during the worst 10-year period for bonds was 10 percent lower than the worst 10-year period for stocks. The chance of losing money over any 10-year period was seven times greater for stocks than it was for bonds. Over any 10-year period, stocks beat bonds every time and never failed to beat inflation. So, based on history, it seems that the longer your investment horizon, the less risky stocks are and the riskier bonds become.

The key takeaway here is that one type of asset isn’t always better than another. How long you can invest for is critical in determining the right mix for you. If you only have a few years to invest, then your money should be mostly in fixed income. If you have savings earmarked for needs five to 10 years or more from now, consider investing some of it in stocks.

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