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Market Victory Is Fleeting

The U.S. stock market has outperformed virtually all other major markets over the last few years, and while we think there will be more gains ahead, history has shown that market leadership will change, and when it does it can occur quickly. We feel one of the biggest errors investors can make is to project recent past performance into the future. This is particularly important today given U.S. stocks' dominant six-year run.

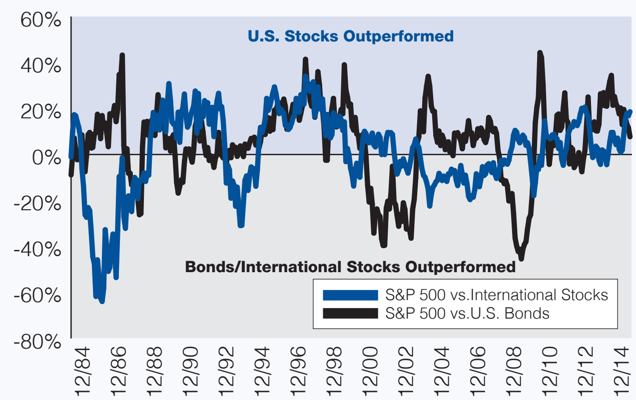
Our research team has prepared a chart to illustrate the point. In it, we calculated 12-month returns for the S&P 500 ending in each month of the year over the past three decades, and did the same for the MSCI EAFE index (representing foreign stocks) and the Barclays U.S. Aggregate Bond index. Subtracting the returns of the MSCI and Barclays indexes from the S&P 500 provides a simple means of seeing which index outperformed over a given 12-month period: When the line is above 0%, U.S. stocks were outperforming; when it dips into negative territory, international stocks or bonds outperformed. We think the 30 years of data illustrate just how fleeting leadership can be when you compare one benchmark against another.

You can see wide swings in both lines over fairly short periods of time. Over the 30 years through 2014, U.S. stocks outperformed foreign stocks by as much as 34.0% over a 12-month period (the one ending in July 1997) and lagged by as much as 63.9% over 12 months (August 1986), with the S&P 500 outgaining the MSCI EAFE by only an average 0.9% overall for the entire period. The chart shows how the two stock market measures have traded off leadership over both longer and shorter periods of time, with outperformance often tipping in favor of one asset class or the other for several years at a time.

It's the same story when you compare the stock market to the bond market, although the largest periods of outperformance and underperformance for stocks were fairly balanced, with max differences in returns of 45.4% in favor of bonds and a 44.3% tilt toward stocks. Interestingly, these periods occurred just a year apart, in February 2009 (when stocks were near their bottom) and February 2010 (as the long recovery began). Over the 30 years, as might be expected, stocks did hold a more sizeable 4.9% average return advantage over 12-month periods. But getting there was, as you can see, not without volatility.

If long-term trends hold true, and we believe that they will, it's only a matter of time before U.S. stocks lag bonds or international stocks, or both, for either a short or an extended period of time. We believe that when that turn comes, the full benefits of a diversified, risk-aware portfolio will become readily apparent.

Outperformance Is Cyclical



Note: Lines show the difference between rolling 12-month total returns for the S&P 500 and those of the MSCI EAFE and Barclays U.S. Aggregate Bond index. Source: Morningstar