



ARE WE IN AN ASSET BUBBLE?

Owning high-valuation assets is detrimental to one's portfolio in the event of a bubble burst. Consider below an excellent graph that illustrates such a scenario. It tracks how long it took investors to get back to an annualized real return of 6 per cent following the bubble's peak. That is the generally recognized long-term return on stocks.

WOUNDS THAT NEVER HEAL

Why so focused on bubbles? The damage they inflict can last decades.

WOUNDS THAT NEVER HEAL

Number of years to get back to earning 6% real



It Is Prudent to Pay Close Attention to Bubbles. The chart above highlights four major U.S. equity bubbles going back to 1929 (the 2008 bubble is included in the 1999 time series) and the Japanese equity bubble of the late 1980's. Each line measures the initial damage done when the bubble bursts, and then tracks how long it subsequently takes an investor to climb back to their "expected" 6% real¹ return. It's typically *decades*. Even with the amazing returns U.S. stocks have delivered for the past ten years, the S&P 500 Index has still not climbed out of the hole created by the tech bubble of 1999 (the red line, above). Bubbles inflict deep and cruel wounds, and it is right and prudent to avoid them, exploit them, or dance around them as best we can.²

¹ - Note that 6% real (or roughly 8% to 8.5% nominal) is a common assumption for equilibrium equity returns. It also is (or historically was) a common long-term equity return assumption for investment consultants, actuaries, pension plans, sovereign wealth funds, endowments, foundations, health care systems, defined contribution systems, family offices, wealth managers, RIAs, CFPs, investment advisors, and individuals.

² - Bubbles are not just for avoiding. They can, and have been, spectacular money-making opportunities, as well. We have a long history of creating strategies that are designed to monetize the massive dislocation in pricing that typically characterizes bubbles. We have one such strategy today that is long a diversified basket of global Value stocks and short a basket of global Growth stocks.



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