BUNK 1 BONDS ARE SAFER THAN STOCKS

Bonds just feel safe. The very name even implies safety—as in, "My word is my bond." Far too many investors with long-term growth goals load up on bonds, presuming they're safer than scary stocks. But are they? Depends largely on how you define "safe."

Does "safe" mean a high probability of lower long-term returns with less near-term volatility? Or is "safe" increasing the probability your portfolio grows enough to satisfy your long-term growth and/or cash flow needs? If you need a certain amount of growth to maintain your lifestyle in retirement, you might not feel so "safe" when you discover having too little volatility risk for too many years later means you must subsequently dial back your lifestyle. And you may not feel "safe" when you must explain that to your spouse—particularly if in that future there is any huge inflation spurt (always possible).

Bonds Can Be Negative, Too

Yes, stocks can be pretty darn volatile and scary—near term. But people forget: Bonds do sometimes lose value in the near term too. In 2009, bonds not only suffered relative to stocks (world stocks were up 30 percent)[1] but also absolutely—10-year US Treasuries *fell* 9.5 percent.[2] Not what you'd expect from über-safety.

Still, stocks can and do fall much more—in 2008, world stocks were down 40.7 percent![3] But remember, these are all short-term returns. Stocks are generally riskier short-term because the expectation is they'll have better returns long-term. And they have! (See Bunk 2 for more on stocks' long-term superiority.) Overwhelmingly, if you've got a long time to invest (and most investors do—see Bunk 3 on how investors usually underestimate their time horizon to their detriment), stocks are typically a better bet. And if you need portfolio growth and can give stocks a bit of time, they have even been the *safer* bet! It's all about time horizons.

Given Just a Bit of Time

Buying stocks with money you need to pay the rent over the next year is always foolish. But the truth is: Given a bit of time, historically stocks have bigger and, surprisingly, *more uniformly positive* returns than bonds. Figure 1.1 shows three-year rolling real returns (adjusting for inflation) of 10-year Treasuries. Note: There are plenty of down periods—in some cases many of them right in a row. You aren't protected from down periods with Treasuries.

Now compare that to Figure 1.2, which shows the same thing but for the S&P 500. (I use US stocks here because they have longer, better data, and we can measure this over a longer period—but the story is generally the same using world stocks.) You actually have *fewer* negative three-year periods historically. Yes, the negative periods can be bigger, but the positive periods are more numerous and simply huger. Stock returns blow away bond returns, with fewer negative three-year periods!

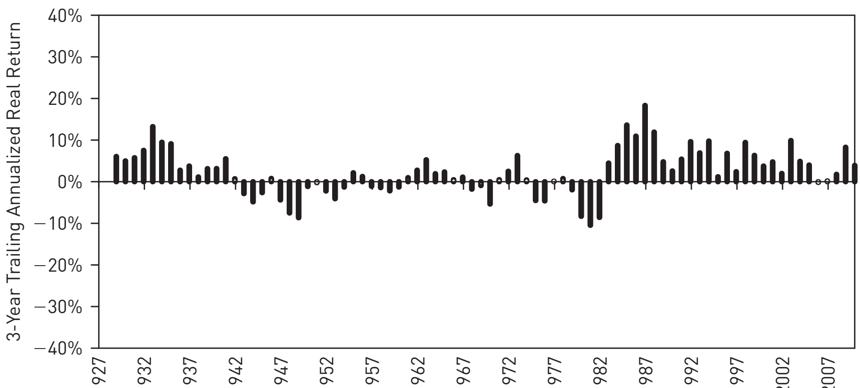

Figure 1.1 US 10-Year Treasuries (Three-Year Rolling Real Returns)—"Safer" Than Stocks?

Source: Global Financial Data, Inc., USA 10-year Government Bond Total Return Index from 12/31/1925 to 12/31/2009.

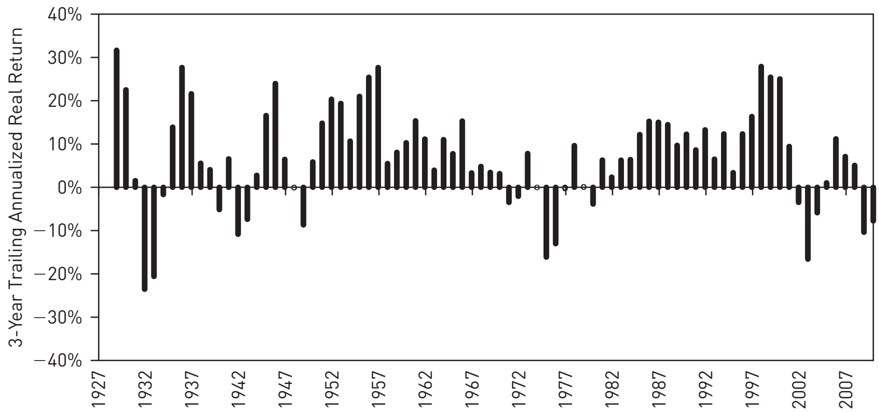

Figure 1.2 US Stocks (Three-Year Rolling Real Returns)—Compare to Bonds
Source: Global Financial Data, Inc., S&P 500 total return from 12/31/1925 to 12/31/2009.

Inflation's Bite

Folks also forget about inflation. If, over your long-term investment time horizon, we have a period (or two) of materially increasing inflation, two things can happen at once. First, long-term interest rates typically rise as inflation does. Bond yields and price have an inverse relationship—so when rates rise, the price and value of your long-term bonds fall proportionally.

Second, and as surely, your bonds get paid back in cheaper, inflated dollars—double whammy! With the amount of recent global money creation (as I write this in 2010) and the huge global deficits, it would be foolish indeed not to consider this a material possible risk. During such inflationary periods, stocks have tended to have lower returns relative to history but positive returns nonetheless (with short-term volatility, of course)—yet returns that generally have beaten inflation and maintained real purchasing power, and then some.

I'm frequently accused of being a perma-bull. I'm not—I've gotten bearish three times in my career thus far and I wrote about it publicly then. (For a history thereof and my other views over the long-term past, see Aaron Anderson's *The Making of a Market Guru*: Forbes *Presents 25 Years of Ken Fisher*, John Wiley & Sons, 2010.)

But I do have a bias to being bullish if I can't find any decent reasons to be bearish. Why? Look at those graphs! Capital markets are super complex. No one person or group of people can understand all the intricate inter-workings of the massive global market. As such, there are no certainties in investing, only probabilities. And history says you should want to be bullish way more than bearish. Bears can't get that. They see the big down periods for stocks and say, "Eek!" But for some reason, they just can't see the plain truth: Stocks are more consistently positive than bonds historically—given just a bit of time. Therefore, over the longer term, they have been less risky. Stocks are safer than bonds? Sure looks that way.