NUVEEN
Investments

THE CASE FOR EQUITY INVESTING

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By the end of 2008, the S&P 500 Index had experienced one of the worst declines in its 83 year history. The emotions that followed caused many investors to move their investments away from equities and into other investments such as cash and bonds. By reacting to negative returns in this way, investors may be doing themselves a great disservice. Behavioral scientists often refer to this behavior as recency bias. Recency bias is the tendency for investors to give recent events more importance or weight, instead of factoring in a more historical perspective, when making important financial decisions. Through recency bias, investors often feel it is easier to emotionally validate a choice when following a trend. This can be evidenced in the flows in and out of mutual funds – when the market is down, **out**flows have increased; when it's up, **in**flows have increased[1]. Recency bias causes investors to chase performance and over-react to short-term events, often resulting in investors buying high and selling low.

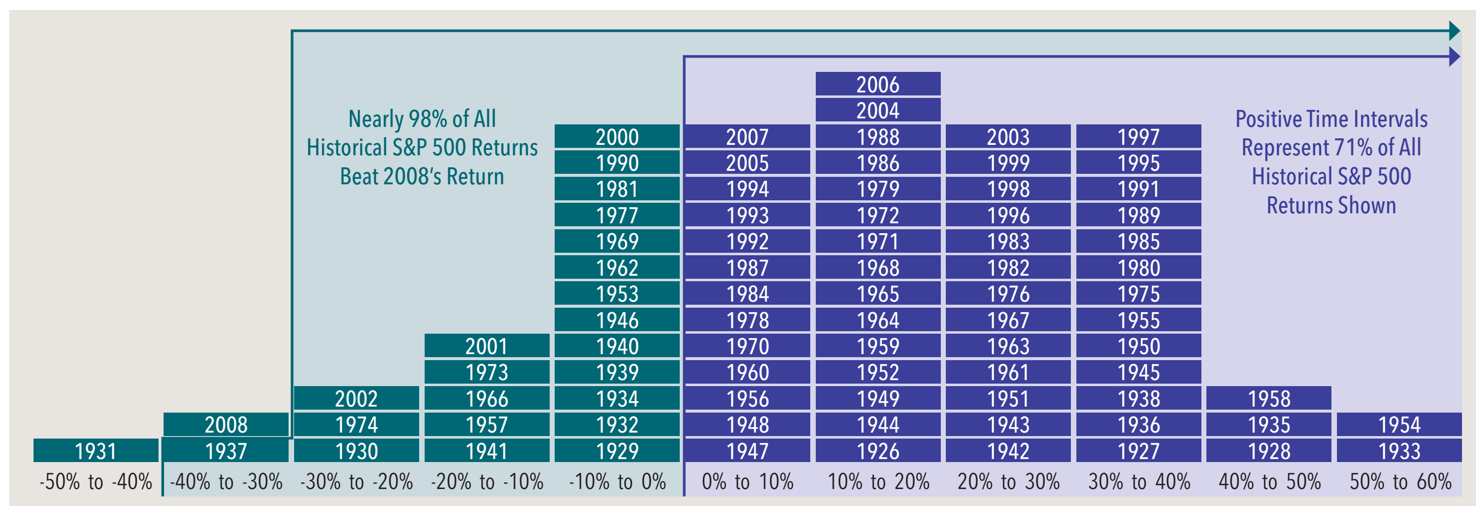
This paper provides a historical perspective on market performance from 1926 (the inception of the S&P 500 Index) through the end of 2008. It also examines the potential benefits of including equities within a diversified portfolio.

PUTTING 2008 INTO PERSPECTIVE

It is important to put 2008 in perspective relative to the entire history of the S&P 500 Index, as illustrated in **Exhibit 1**. The -37.0% 2008 return made it the second worst performing year since inception of the S&P 500 Index, experiencing a return that only outperformed the 1931 return of -43.3% (the peak of the Great Depression); the other year in this performance range, 1937, returned -35.1%. Put another way, since 1926, nearly 98% of the S&P 500's annual returns were greater than in 2008, and 71% of all annual returns have been positive. This data suggests that there will be ebbs and flows. However, the growth of the S&P 500 over time has been positive, averaging an annual return of 9.6% since inception through December 31, 2008[2].

Exhibit 1 – S&P 500 Annual Total Return History by Perfomance Ranges

(January 1, 1926 – December 31, 2008)



Past performance is no guarantee of future results. Data source: S&P 500 Index as tracked by the Ibbotson Associates Large Company Stock Index. Chart represents distribution of S&P 500 annual total returns data for January 1926 through December 2008. Returns are ranked in order of occurance with the most recent year on top for each performance range. This time period represents the complete historical Ibbotson Associates data available, for this index, through December 31, 2008. Index returns include reinvestment of income but do not reflect inflation, fees, taxes or transaction costs that would reduce performance in an actual account. All indices are unmanaged and unavailable for direct investment. Other benchmarks and methods may produce different results, and different periods and market conditions may result in significantly different outcomes. This example is shown for illustrative purposes only. It is not intended to predict or represent the results of an actual investment. It is important to remember that there are risks inherent in any investment including loss of principal and there is no assurance that any asset class or index will provide positive performance over time.

SEE ADDITIONAL DISCLOSURES AND SOURCE REFERENCES ON PAGE 5.

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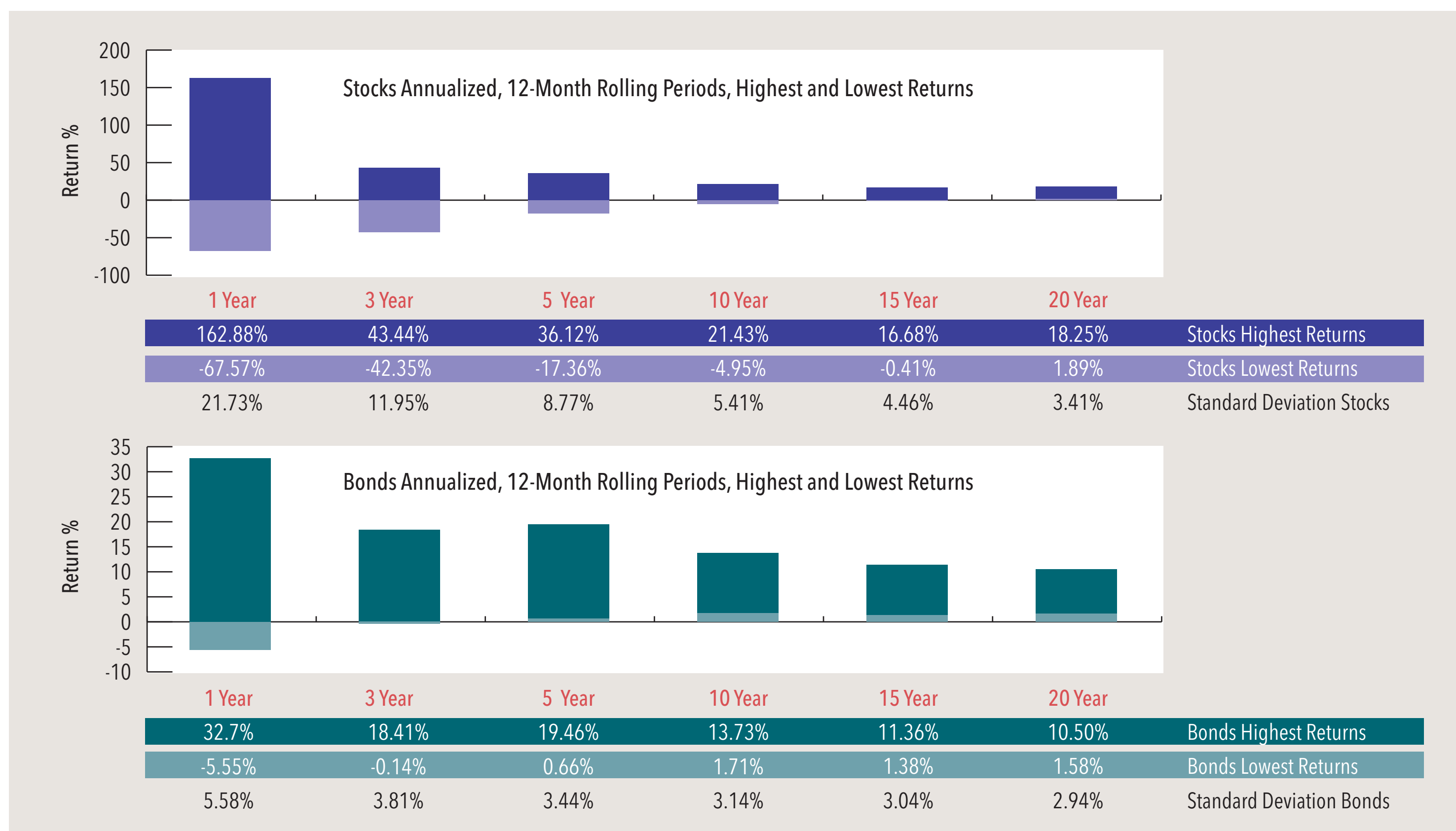
MANAGING RISK WITH EQUITIES OVER THE LONG TERM

Increasing one's investment time horizon can help smooth out the impact of market disruptions and reduce portfolio risk. As concerns about the U.S. economy continue to make headlines, many investors have become more risk averse, and have shifted their allocations away from equities. Behavioral scientists most commonly link this to an element of recency bias, or loss aversion. Individuals who have experienced loss are sometimes hesitant to "get back in the game," because they are afraid that they will experience a loss again.

Although equities are typically more volatile in the short term, over longer time horizons, equities have provided decreased return dispersion at a reduced risk level. As illustrated in the **Exhibit 2**, from 1926 to 2008, the highest return during any twelve month period for the S&P 500 was 162.88%, and the lowest return during any twelve month period was -67.57%. This wide range of returns resulted in a higher level of risk (21.73%), as measured by standard deviation. Comparatively, the range of twelve month returns for bonds during this same period ranged from 32.70% to -5.55%, with a risk level of only 5.58%. But as Exhibit 2 further illustrates, as the time horizon increases, the range of returns for stocks narrows, resulting in a decreased range of volatility and risk.

Exhibit 2 – Historical Range of Returns of Stocks and Bonds for Different Holding Periods

(January 1, 1926 – December 31, 2008)



	1 Year	3 Year	5 Year	10 Year	15 Year	20 Year
Stocks Highest Returns	162.88%	43.44%	36.12%	21.43%	16.68%	18.25%
Stocks Lowest Returns	-67.57%	-42.35%	-17.36%	-4.95%	-0.41%	1.89%
Standard Deviation Stocks	21.73%	11.95%	8.77%	5.41%	4.46%	3.41%

	1 Year	3 Year	5 Year	10 Year	15 Year	20 Year
Bonds Highest Returns	32.7%	18.41%	19.46%	13.73%	11.36%	10.50%
Bonds Lowest Returns	-5.55%	-0.14%	0.66%	1.71%	1.38%	1.58%
Standard Deviation Bonds	5.58%	3.81%	3.44%	3.14%	3.04%	2.94%

Past performance is no guarantee of future results. Data source: Ibbotson Associates. Periods greater than one year have been annualized. Chart represents annualized returns calculated over 12 month rolling periods. Standard deviation is a measure of the dispersion of a set of data from its mean; in finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility. The following proxies were selected for this example. Stocks: S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index; Bonds: One-bond Intermediate-Term Government Bonds portfolio. This analysis is based on rolling 12-month data for January 1926 through December 2008. This time period represents the complete historical Ibbotson Associates data available, for these indices, through December 31, 2008. Index returns include reinvestment of income but do not reflect inflation, fees, taxes or transaction costs that would reduce performance in an actual account. All indices are unmanaged and unavailable for direct investment. This report contains no investment advice or recommendations and is provided for informational purposes only. Other benchmarks and methods may produce different results, and different periods and market conditions may result in significantly different outcomes. Diversification does not ensure against market loss. This example is shown for illustrative purposes only. It is important to remember that there are risks inherent in any investment including loss of principal and there is no assurance that any asset class or index will provide positive performance over time.

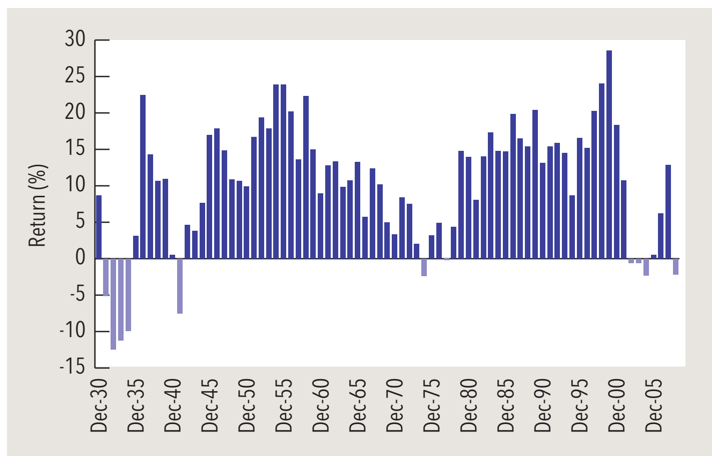
SEE ADDITIONAL DISCLOSURES AND SOURCE REFERENCES ON PAGE 5.

INVESTORS MAY BENEFIT FROM HOLDING STOCKS FOR LONGER PERIODS

Time horizons can range from seconds, in the case of a day trader, all the way up to decades for a buy-and-hold investor. There is no "right" time frame – it depends on the investor's individual objectives and tolerance for risk. Conventional wisdom dictates that the longer an investor has to reach their financial objective, the greater the allocation to equities should be. For example, an individual who is approaching retirement may have a smaller allocation to equities than an individual who is just entering the workforce. Allocating a portion of your portfolio to equities can provide the growth potential needed to achieve your goals over the long term. **Exhibit 3** examines five-year holding periods for each year ending 1930 through 2008. As illustrated, 85% of the time (69 out of 80 such periods) the S&P 500 Index delivered positive results with a five-year average annualized return of 10.28% as of December 31, 2008[3].

Exhibit 3 – S&P 500 Average Annualized Returns

For 5 Year Periods (January 1, 1926 – December 31, 2008)



Past performance is no guarantee of future results. Data source: Ibbotson Associates. The following proxy was selected for this example. Stocks: S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index. This analysis is based on five year annualized returns at the end of each year from December 1930 through December 2008. This time period represents the complete historical Ibbotson Associates data available, for these indices, through December 31, 2008. Index returns include reinvestment of income but do not reflect inflation, fees, taxes or transaction costs that would reduce performance in an actual account. All indices are unmanaged and unavailable for direct investment. This report contains no investment advice or recommendations and is provided for informational purposes only. Other benchmarks and methods may produce different results, and different periods and market conditions may result in significantly different outcomes. This example is shown for illustrative purposes only. It is not intended to predict or represent the results of an actual investment. It is important to remember that there are risks inherent in any investment including loss of principal and there is no assurance that any asset class or index will provide positive performance over time.

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IMPORTANCE OF AN ALLOCATION TO EQUITIES

As previously mentioned, 2008 proved to be an unusual year, ultimately leading investors to shift to what is currently in favor (at the time of publishing this report): bonds. But according to a weekly survey of Wall Street strategists by Bloomberg News, as of June 8, 2009 the average recommended allocation to stocks was 53.5%, while the average recommended allocation to bonds was 37.6% and 7.3% to cash[4]—suggesting that equities are considered an important part of an investor's portfolio.

BEAR MARKET RECOVERY WITH EQUITIES

As with bear markets of the past, the bear market of 2008 inspired fear and caused many investors to withdraw from the market completely, waiting for it to recover before they reinvest. No one can predict when the market will begin to recover, but trying to time the market may result in investors missing out on much of the market's rebound. Missing the first year of returns can be significant. For example, as illustrated in **Exhibit 4**, the average one-year return in the S&P 500 for the first year after a market trough was 33%. Five years after

Exhibit 4 – Equities after a Bear Market

Hypothetical Example (January 1, 1926 – December 31, 2008)

Annualized Return After Trough

	1 Year	3 Year	5 Year
	Stocks	Stocks	Stocks
Average	33%	18%	15%
Median	31%	17%	16%
High	59%	28%	30%
Low	23%	10%	5%

Staying Out of the Market for the First Year After Trough

	1 Year	3 Year	5 Year
	Stocks	Stocks	Stocks
Average	0%	7%	9%
Median	0%	8%	10%
High	0%	13%	18%
Low	0%	1%	-1%

Past performance is no guarantee of future results. Data Source: Ibbotson Associates. The following proxies were selected for this example. Stocks: S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index. This data is based on monthly total returns data. The calculation for the trough begins the first month of the trough + 12 months. The example shown is hypothetical and designed to illustrate the potentially negative effects of market timing. It is not intended to predict or represent the results of an actual investment. Different benchmarks and economic periods will produce different results. All indices are unmanaged and unavailable for direct investment. An individual investor's experience will vary and there is no assurance that an investment will provide positive performance over time.

a bear market, stocks averaged a 15% annualized return. The impact of this in dollar terms is significant. Suppose two investors have $100 to invest. The first investor stays out of the market the first year after the trough – he/she still have $100 one year later. Another investor enters the market, experiencing the recovery. Based on receiving the one year average rate of return of the S&P 500 Index, one year after the trough this investor would have $133. Even if both investors earn the same returns over the next four years, the first investor, who enters the market in year two, because this investor missed the first year of equity returns, would have only $154; the investor who stayed in the market would have $201, a difference of 31%. Past performance is no guarantee of future returns. It is not possible to predict any investment outcomes. The results for individual portfolios and for different periods may vary depending on market conditions and the composition of the portfolio.

EQUITIES IN A DIVERSIFIED PORTFOLIO

Equities within a portfolio over the long-term can be used to generate capital appreciation, while bonds or fixed income are generally used to preserve principal, generate current income, and mitigate market volatility and portfolio risk. Diversification strives to smooth out unsystematic risk events in a portfolio so that the positive performance of some investments will neutralize the negative performance of others. It has been argued that an undiversified fixed-income portfolio is actually riskier than a diversified portfolio that includes equities and alternative investments. But note, diversification alone does not guarantee a profit nor protect against loss. Investors may be well served to work with their advisor to periodically review and rebalance their portfolio, reassess their long-term objectives, and determine the appropriate allocation to equities based on their financial goals.

SEE ADDITIONAL DISCLOSURES AND SOURCE REFERENCES ON PAGE 5.

DISCLOSURES

Investing entails risks and there can be no assurance that any investment or asset class will provide positive performance over any period of time. Stocks or equity securities involve market risk or the risk that stocks will decline in response to such factors as adverse company news or industry developments or a general economic decline. Bonds and other fixed-income investments involve interest rate risk, the risk that interest rates will rise, causing bond prices to fall; and credit risk, the risk that an issuer will be unable to make interest and principal payments when due.

ENDNOTES

S&P 500: A capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic economy.

Stocks: Stocks Total Return is based upon the S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index. The S&P Composite Index includes 500 of the largest stocks (in terms of stock market value) in the United States; prior to March 1957 it consisted of 90 of the largest stocks.

Bonds: Bonds Total Return consists of a one-bond Intermediate-Term Government Bonds portfolio* with an approximate maturity of five years. The bond chosen each year is the shortest noncallable bond with a maturity not less than five years, and it is held for the calendar year.

* Ibbotson Associates uses this portfolio to compare bond returns over time.

Cash: Cash Total Return consists of a one-bill U.S. Treasury Bills portfolio with an approximate maturity of 30 days. Each month a one-bill portfolio containing the shortest-term bill having not less than one month to maturity is constructed.

REFERENCES

1. Source: Bloomberg and Simfund Database of Equity mutual funds.
2. Source: S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index. The average annual return is based on the geometric mean based on monthly returns from January 1926 to December 2008.
3. Source: S&P 500 stocks as tracked by the Ibbotson Associates Large Company Stock Index. The average five-year annual return is based on average of total sum of all the five year means (each mean is based on the geometric mean for each five year period from 1926-2008).
4. Source: Bloomberg.com, Strategists' S&P 500 Forecasts, Allocation Guidelines (Table), Updated June 8, 2009, most recent data available.

IMPORTANT DISCLAIMERS

This analysis indicates past performance of market benchmarks over the time periods specified and in no way should be considered representative of the past performance of any actual investment product or predictive of future investment expectations and performance for these benchmarks or any actual investment products. Past performance is no guarantee of future results. Different benchmarks, methods and economic periods will produce different results. The results for individual portfolios may vary depending on market conditions and the composition of the portfolio. These index returns include reinvestment of income but do not reflect inflation, fees, taxes or transaction costs that would reduce performance in an actual account. All indices are unmanaged and unavailable for direct investment. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results.

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There is no assurance that any predicted results will actually occur. In making an investment decision individuals should utilize other information sources and the advice of their investment advisor. All investments carry a certain degree of risk, including possible loss of principal, and there is no assurance that an investment will provide positive performance over any period of time. An investment in stocks or other equity securities are subject to market risk or the risk that stocks in the portfolio will decline in response to such factors as adverse company news or industry developments or a general economic decline. **If used in connection with the offering of a mutual fund, this report must be preceded or accompanied by a prospectus.**

GLOSSARY

Great Depression: An economic recession that began on October 29, 1929, following the crash of the U.S. stock market.

Standard devation: In finance, standard deviation is applied to the annual rate of return of an investment to measure the investment's volatility.

Bear Market: A peak-to-trough decline of at least 20% of the S&P 500 Index.

Trough: The stage of the economy's business cycle that marks the end of a period of declining business activity and the transition to expansion.

Volatility: The relative rate at which the price of a security moves up and down.

Rebalancing: The process of realigning the weightings of one's portfolio of assets. Rebalancing involves periodically buying or selling assets in your portfolio to maintain your original desired level of asset allocation.

Alternative investments: Investments considered outside of the traditional asset classes of stocks, bonds and cash. Examples of alternative investments include real estate, commodities, options and financial derivatives. Alternative investments are often used by hedge funds.

Unsystematic risk: Company or industry specific risk that is inherent in each investment. The amount of unsystematic risk can be reduced through appropriate diversification.

Glossary source: investopedia.com, investorwords.com

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