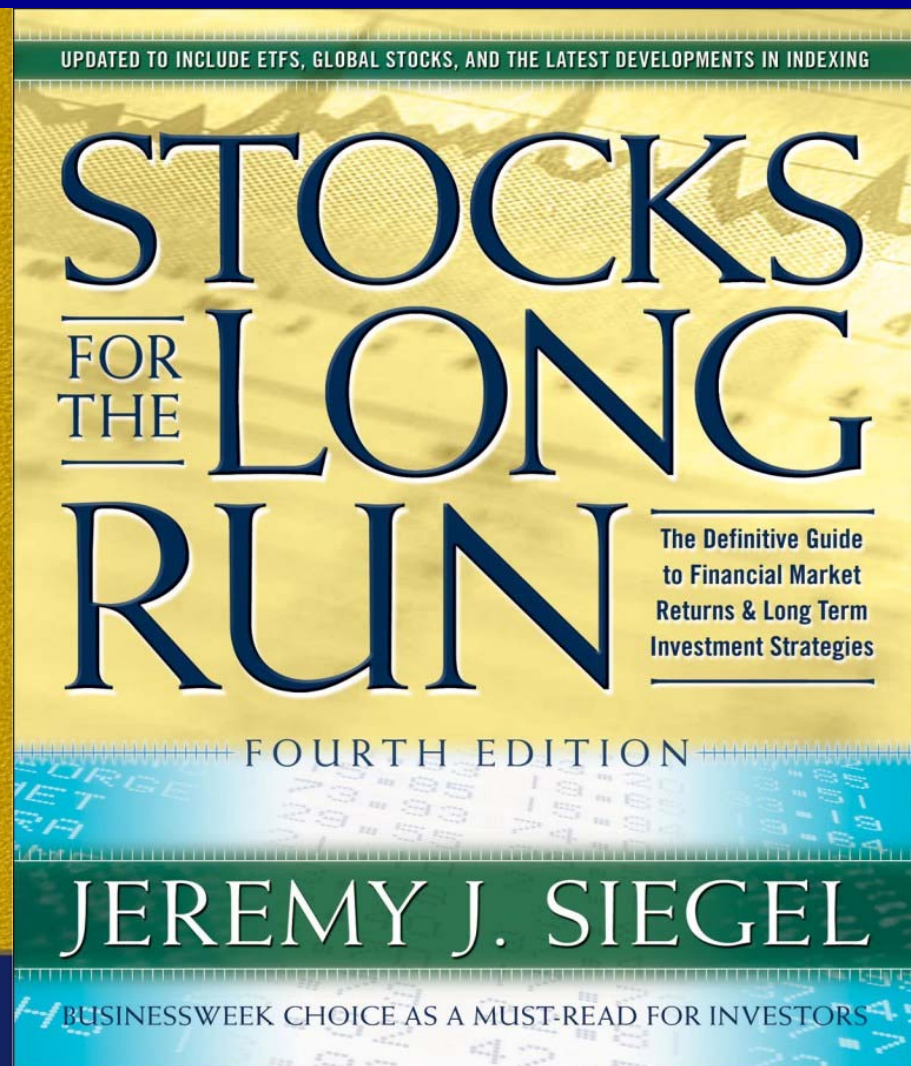
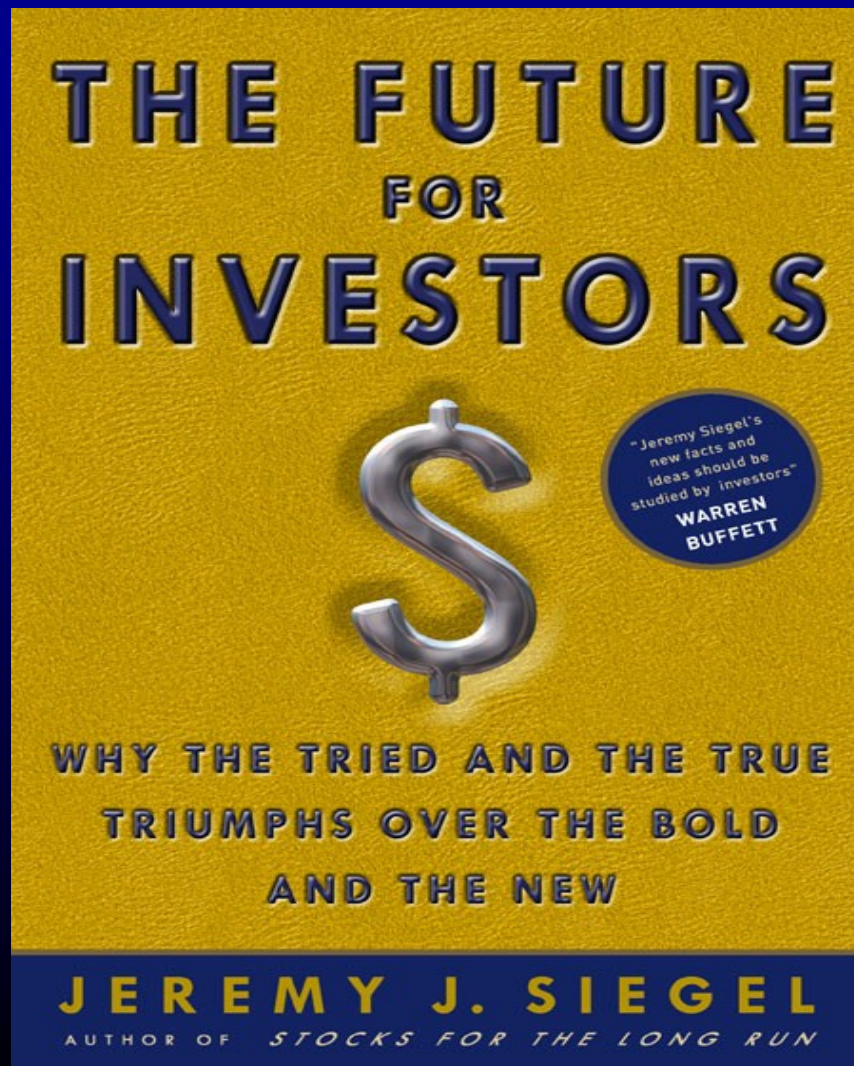


What's Ahead for the Markets and the Economy?

Prof. Jeremy J. Siegel ~ The Wharton School

CoBank Executive Forum ~ August 23, 2012



Important Information

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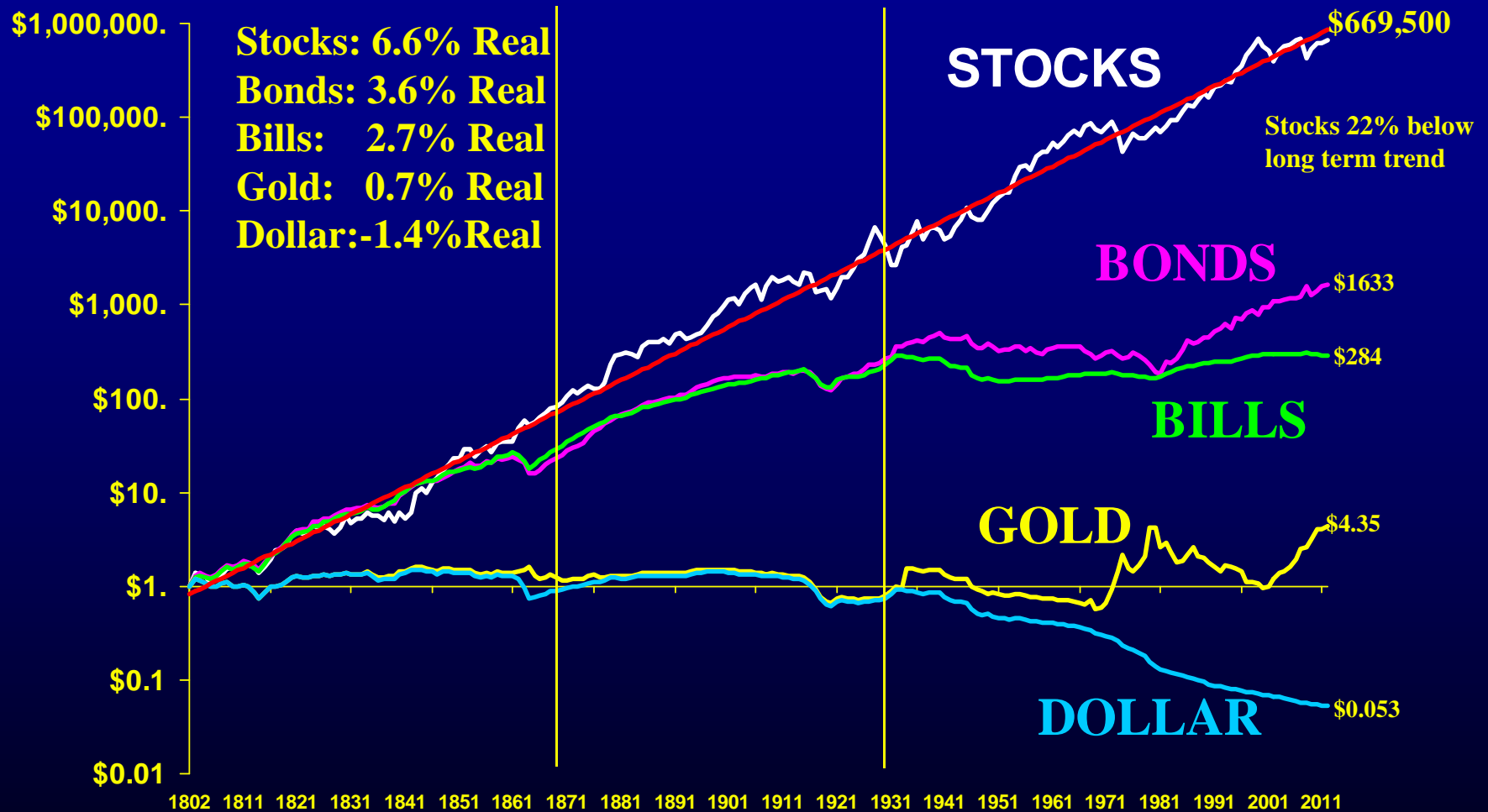
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Definition of major asset classes / indexes

- The source data on the return series for the major asset classes can be found in Professor Siegel's book *Stocks for the Long Run, 4th edition*. Professor Siegel compiled his own proprietary indexes on each asset class and updates each data series from the book to reflect most recent periods.
- Stocks: The total returns after inflation on the broadest index of stocks available at the time. (Stocks-real-total return index: 1802-2011)
- Bonds: The total returns on an index on U.S. government bonds after inflation. (Bonds-real-total return index: 1802-2011)
- Bills: Total returns on U.S. Treasury Bills after inflation. (Bills-real-accumulative index: 1802-2011).
- Gold: The value of 1 dollar of gold bullion after inflation. (Gold-real-price index: 1802-2011)
- Dollar : The purchasing power of one US dollar. (Money: 1802-2011)
- Index performance assumes reinvestment of dividends, but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in Fund shares.

Total Real Return Indexes

January 1802 – June 2012



Source: Siegel, Jeremy, *Future for Investors* (2005), *With Updates to 2012*

Past performance is not indicative of future results.

Annual Stock Market Returns

<u>Updated through June 2012</u>		Real Returns
Long- Term	1802-2012	6.6%
Major Sub- Periods	I 1802-1870	6.7%
	II 1871-1925	6.6%
	III 1926-2012	6.4%
Post-War Periods	1946-2012	6.4%
	1946-1965	10.0%
	1966-1981	-0.4%
	1982-1999	13.6%
	2000-2012	-0.1%

Source: Siegel, Jeremy,
Stocks for the Long Run
(2008) with updates to 2012

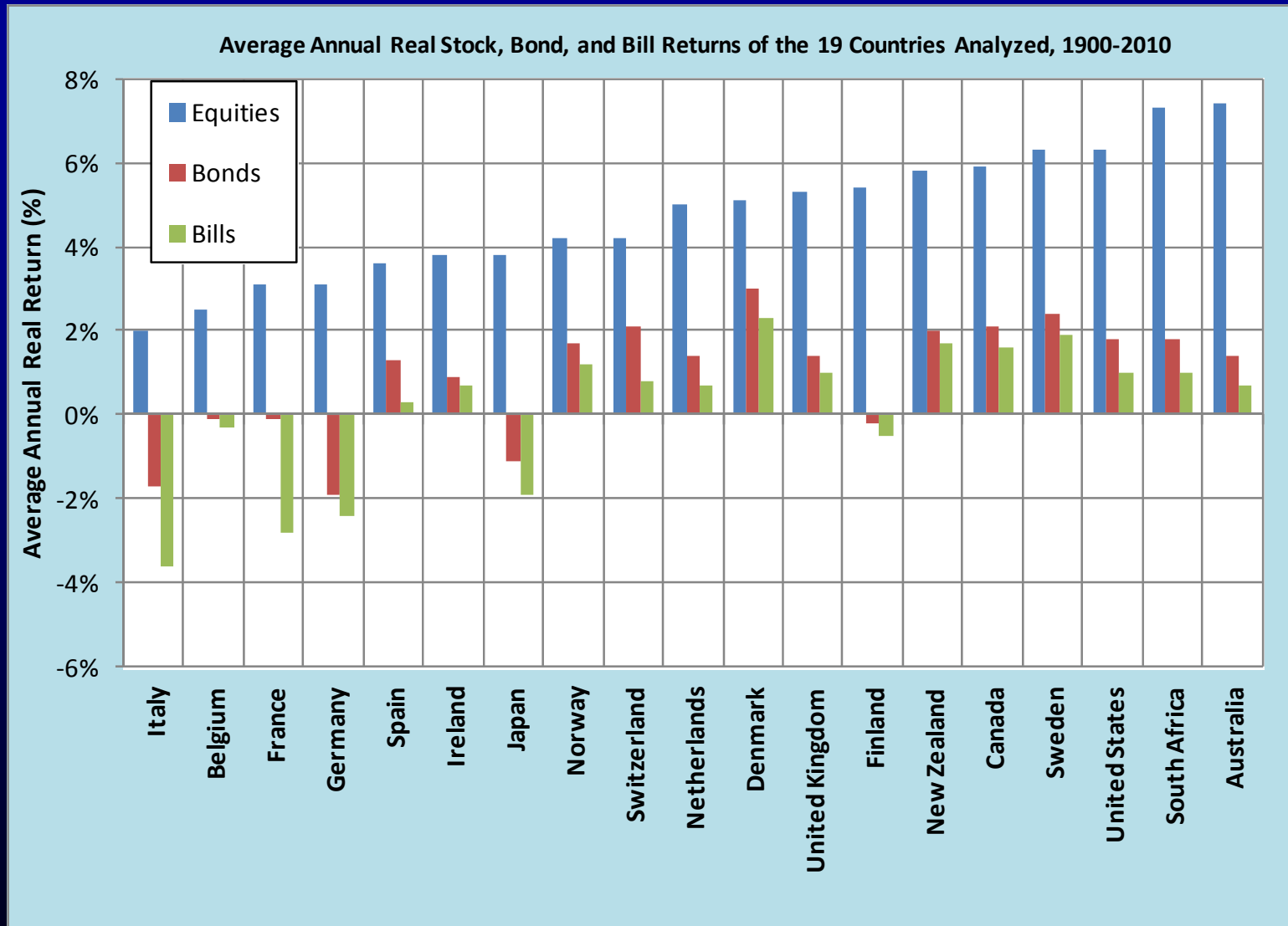
Past performance is not indicative of future results.

Annual Bond Market Returns

<u>Updated through June 2012</u>		Real Returns
Long- Term	1802-2012	3.6%
Major Sub- Periods	I 1802-1870	4.8%
	II 1871-1925	3.7%
	III 1926-2012	2.5%
Post-War Periods	1946-2012	1.9%
	1946-1965	-1.2%
	1966-1981	-4.2%
	1982-1999	8.5%
	2000-2012	6.0%

Source: Siegel, Jeremy,
Stocks for the Long Run
(2008) with updates to 2012

Worldwide Stock, Bond, and Bill Returns

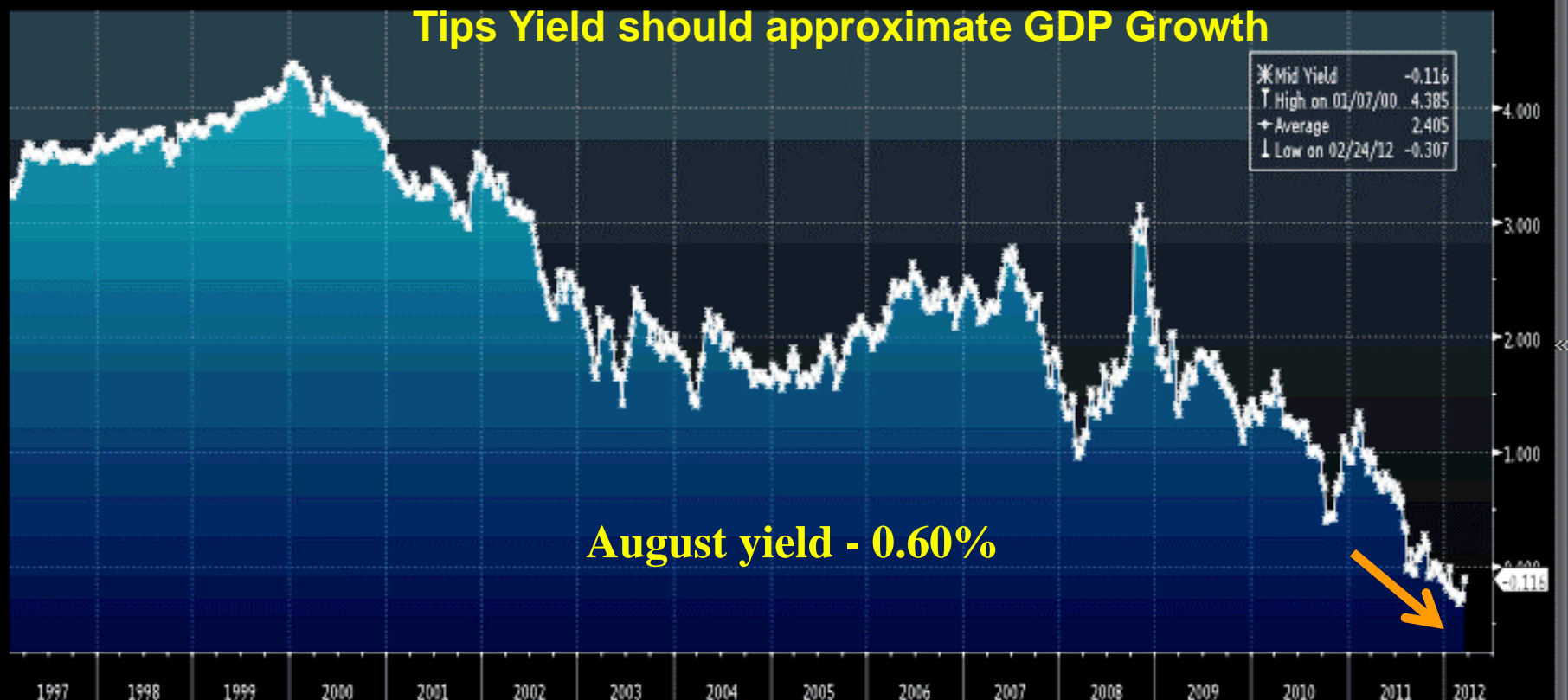


Source: Source: Dimson, Marsh, Staunton, Triumph of the Optimists; authors' updates

Past Performance is no guarantee of future results

Ten-Year TIPs Yield 1997-2012

GRAB Govt **GY**
 TSY INFL IX N/B TII0 $\frac{1}{8}$ 01/15/22 102-09 /102-15+ (-0.11 /13) BGN @17:00
 GTII10 GOVT Save Chart Hide GY - Yield Chart Page 1/22
 Range 01/31/97 - 03/16/12 Upper Mid Yield to Wo Mov. Avgs Currency USD
 Period Weekly Lower None Mov. Avg Events



1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012
 Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
 Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000
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Past performance is not indicative of future results.

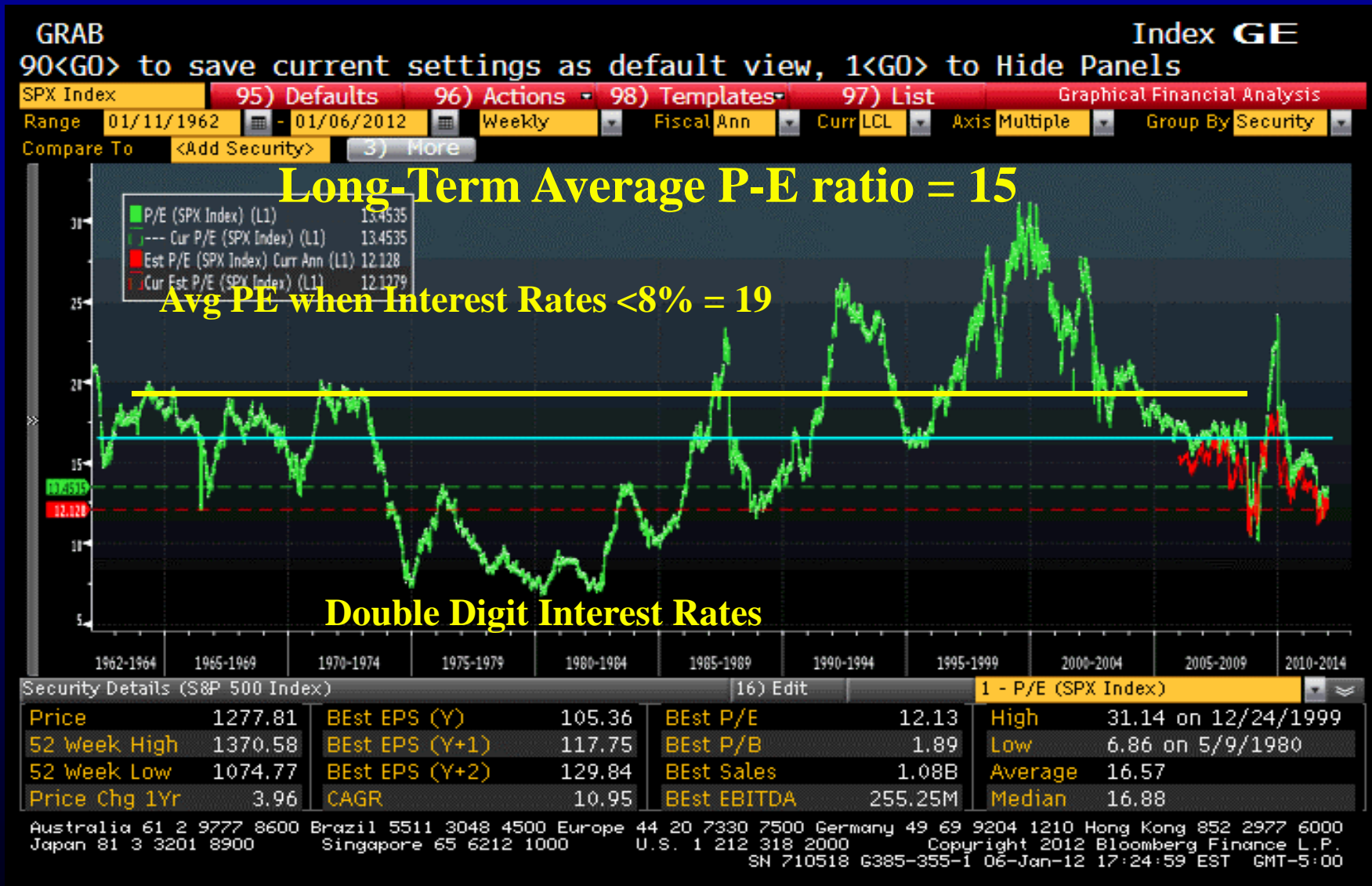
Source: Bloomberg

Global Valuation

Returns and Price / Earnings Ratio

- ❑ Price/Earnings Ratio (or P/E ratio) is a valuation metric of stocks and relates how much one is paying for a stock or an index for each dollar of earnings for that stock or index.
- ❑ Average P-E ratio in last 130 years of S&P 500 Index = 15.
- ❑ But just as important is the *Earnings Yield*, or (1/ Price-Earnings ratio). The earning yield, or E/P has been an excellent long-term predictor of **real** stock returns.
- ❑ The average earnings yield 6.7%, virtually identical to long-run real stock return.

P-E Ratio on S&P 500, 1962-2012



Source: Bloomberg

What is the S&P500 worth today?

- 2011 earnings for the S&P 500 came in at \$96.44. 2012 operating earnings are estimated at \$102.48. 2013 are estimated at \$115.56. At August 10 level of the S&P 500 of 1404, the market is selling at a Price to Earnings Ratio of 13.7 times 2012 earnings.
- At 15 times 2012 earnings, the S&P 500 is 1540; 10% above current levels, at 19 times earnings the S&P 500 is at 1947, 39% above the current levels. Levels are 12% higher based on 2013 earnings.
- Current earnings yields projects a 7.3% real return, about 8 percentage points over TIPS, and more than twice the historical average.
- *Earnings do not have to increase for stocks to dominate bonds.*

World P-E Ratios

GRAB
Enter 1,2,3 or number <Go> for a historical graph of the earnings.

World Equity Index Ratios

Measure 1 Price/Earnings

2011 2012 2013

EquityWPE

97) WEI 98) EMEQ

Measure	Price/Earnings	Price	Net Chg	Price/ Earnings	Curr Yr Est.	Nxt Yr Est.
1) North/Latin America						
4) INDU	DOW JONES INDUS.	13008.68	-64.33	12.93	12.52	11.51
5) SPX	S&P 500 INDEX	1379.32	-5.98	14.01	13.41	11.99
6) CCMP	NASDAQ COMPOSITE	2939.52	-6.32	16.70	15.94	13.43
7) SPTSX	S&P/TSX COMPOSIT	11664.71	-93.17	13.91	13.99	12.06
8) MEXBOL	MEXICO IPC INDEX	40704.28	-628.83	18.97	15.99	15.16
2) Europe/Africa/Middle East						
9) SX5E	Euro Stoxx 50 Pr	2325.72	-14.59	19.53	9.76	8.78
10) UKX	FTSE 100 INDEX	5635.28	-58.35	11.43	10.53	9.56
11) CAC	CAC 40 INDEX	3291.66	-29.05	11.10	9.99	9.13
12) DAX	DAX INDEX	6772.26	-1.80	14.46	10.15	9.27
13) IBEX	IBEX 35 INDEX	6738.10	-63.70	13.36	10.90	8.25
14) FTSEMIB	FTSE MIB INDEX	13890.99	-87.05	neg	8.94	7.69
15) AEX	AEX-Index	326.47	-2.18	13.08	10.45	9.23
16) SMI	SWISS MARKET IND	6399.27	-3.11	16.95	12.90	11.50
3) Asia/Pacific						
17) NKY	NIKKEI 225	8695.06	59.62	20.73	13.23	12.16
18) HSI	HANG SENG INDEX	19796.81	211.41	9.55	10.43	9.46
19) SHCOMP	SHANGHAI SE COMP	2103.63	-6.28	11.34	9.44	8.19
20) AS51	S&P/ASX 200 INDE	4269.15	23.44	14.57	12.25	10.84
21) FSSTI	Straits Times In	3036.40	3.60	12.22	13.97	12.64

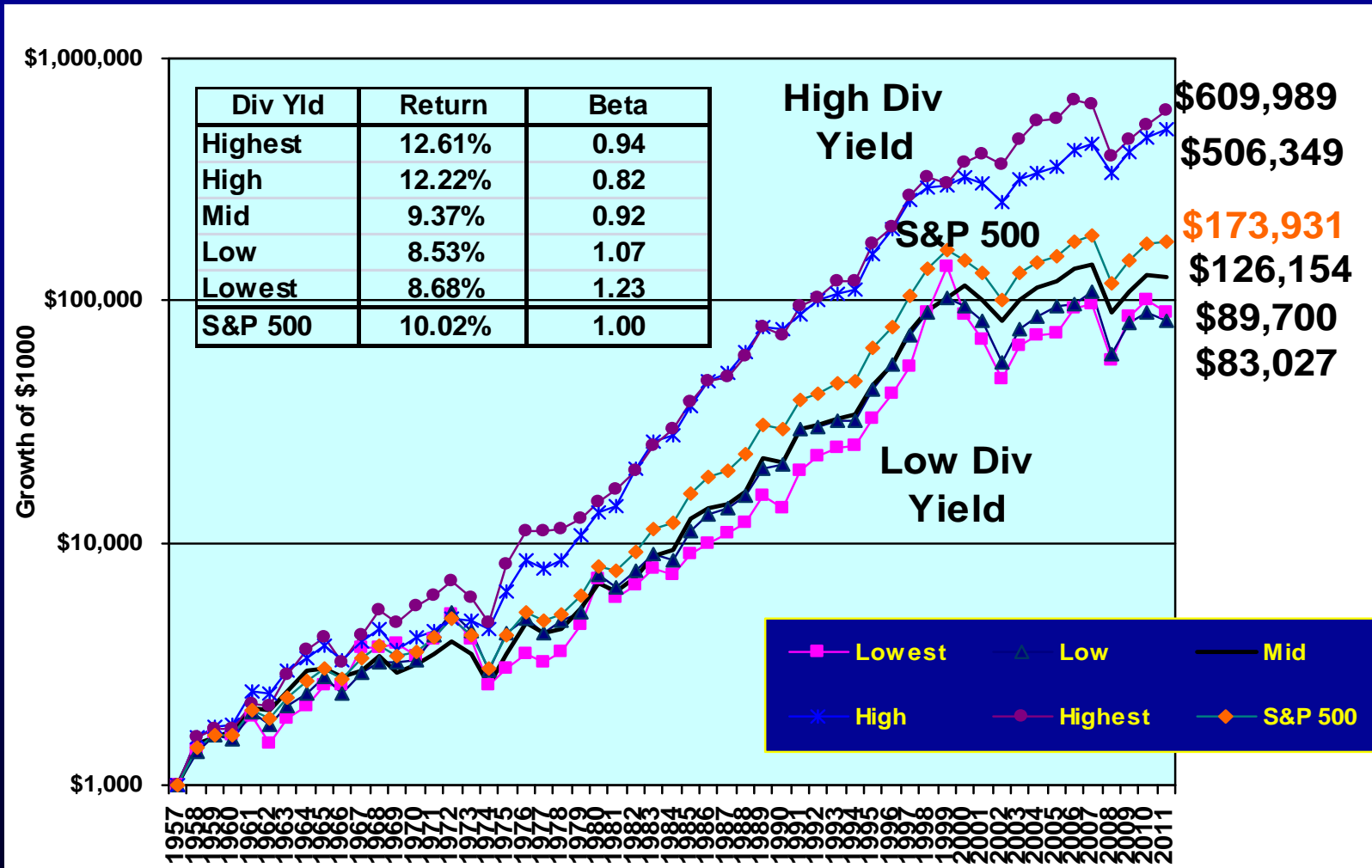
Australia 61 2 9777 8600 Brazil 5511 3048 4500 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2012 Bloomberg Finance L.P.
SN 831730 G549-2780-0 31-Jul-12 16:24:36 EDT GMT-4:00

Source: Bloomberg

Past performance is not indicative of future results.

Value Stocks
Have Historically Paid
Dividends
Over the Long Run

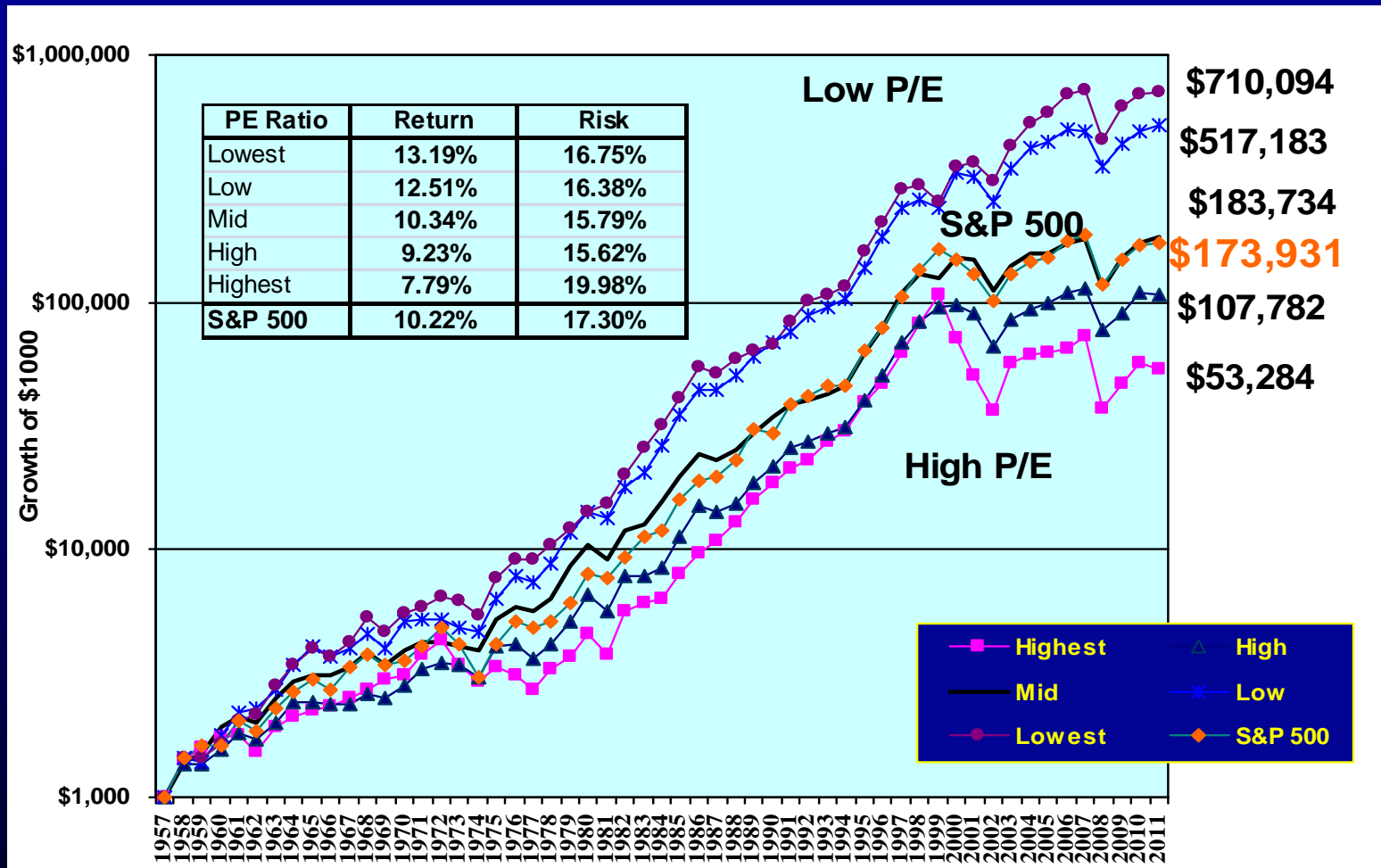
Dividend Yield and Relative Performance, 1957-2011



Source: Siegel, Jeremy, *Future for Investors* (2005), With Updates to 2011

Each stock in S&P 500 is ranked from highest to lowest by dividend yield on December 30st of every year and placed into “quintiles,” baskets of 100 stocks in each basket. The stocks in the quintiles are weighted by their market capitalization. The dividend yield is defined as each stock’s annual dividends per share divided by its stock price as of December 30st of that year.

Price / Earnings Ratio and Relative Performance, 1957-2011



Source: Siegel, Jeremy, *Future for Investors* (2005), With Updates to 2011

Each stock in S&P 500 is ranked from lowest to highest by price to earnings ratio on December 30st of every year and placed into “quintiles,” baskets of 100 stocks in each basket. The stocks in the quintiles are weighted by their market capitalization. The price/ earnings ratio is defined as each stock’s net income per share divided by its stock price as of December 30st of that year.

Past performance does not guarantee future results.

The “Lost Decade” 2000 through 2011

Annual S&P 500 Return + 0.57%

Annual Returns to **Dividend Yield** Quintiles

- **Lowest: -** -3.53%
- **Low** -1.73%
- **Mid** +1.73%
- **High** +4.52%
- **Highest** +5.90%

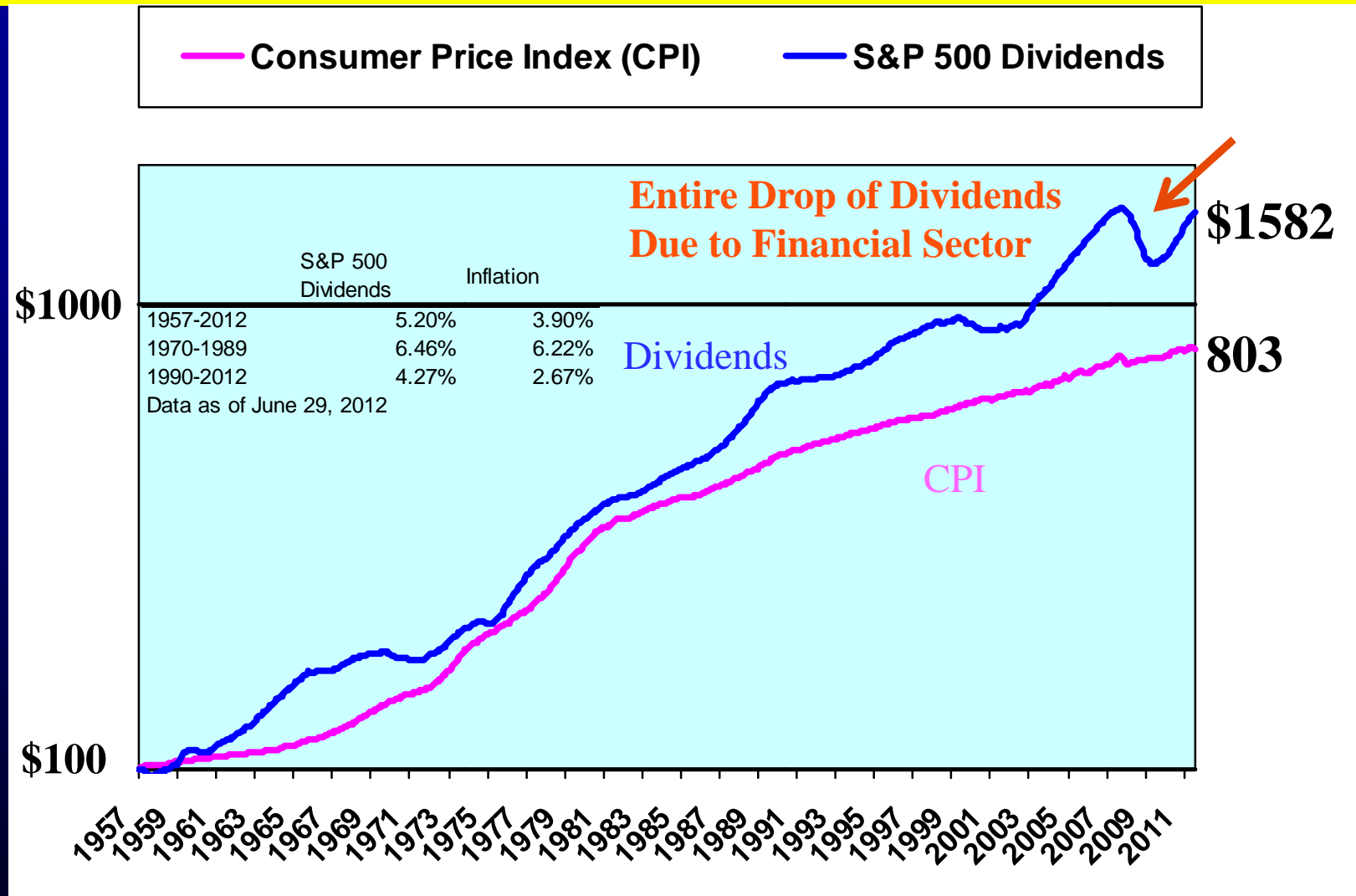
Annual Returns to **Price-to-earnings** Quintiles

- **Highest** -5.68%
- **High** +0.98%
- **Mid** +3.24%
- **Low** +6.50%
- **Lowest** +8.91%

Source: Siegel, Jeremy, *Future for Investors* (2005), *With Updates to 2011*

Past performance is not indicative of future results.

Dividend Income beat inflation



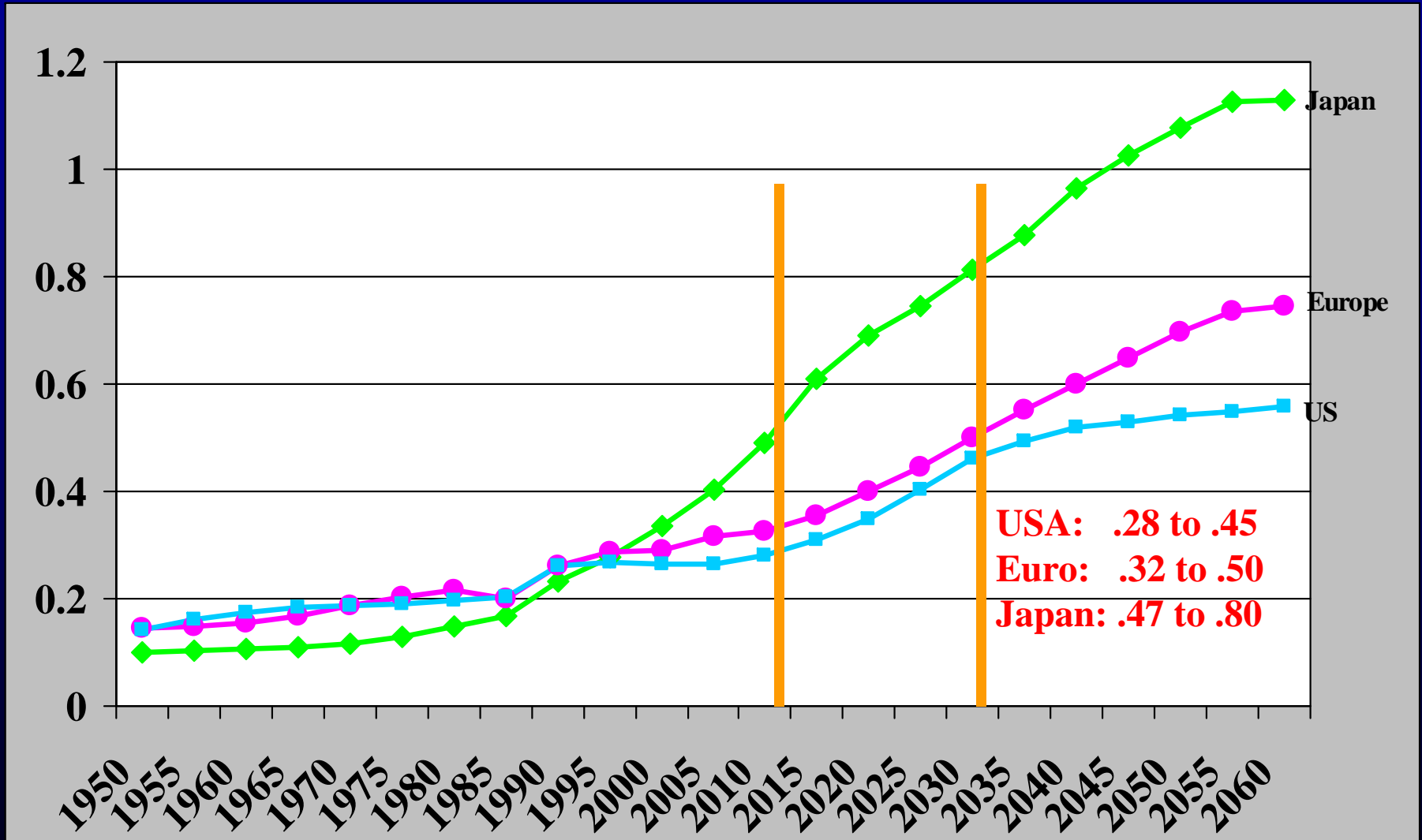
Data from June 30, 2012

Source: Bob Shiller, <http://www.econ.yale.edu/~shiller/data.htm>

Most Important Development in Next 20 Years

- **In the next 20 years, 40 million Americans will become 65 years old, putting unprecedented demands on Social Security and Medicare, setting our national debt on an unsustainable path.**
- **Even more strain on the older European and Japanese economies, as an additional 44 million will demand benefits.**
- **This increase will lead to a rapid increase in the number of retirees per worker.**

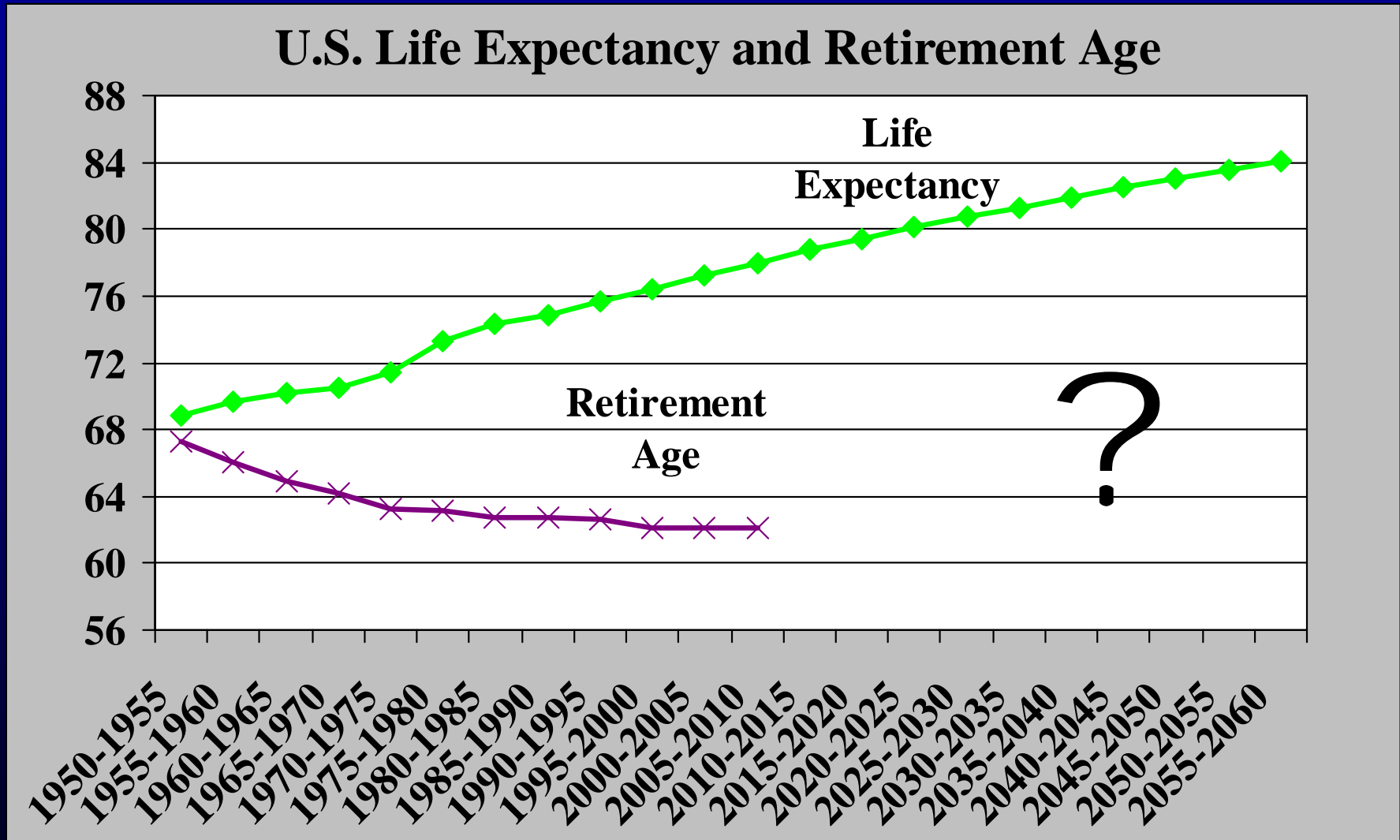
Ratio of Retirees (Age 65+) to workers (Age 20-64)



Most Critical Question Facing Us

- Will there be enough *workers* to produce the goods that will be demanded by retirees, who consume but do not produce?
- Will there be enough *savers* to buy the literally trillions of dollars of assets that these retiree will sell into the market in order to finance their consumption?

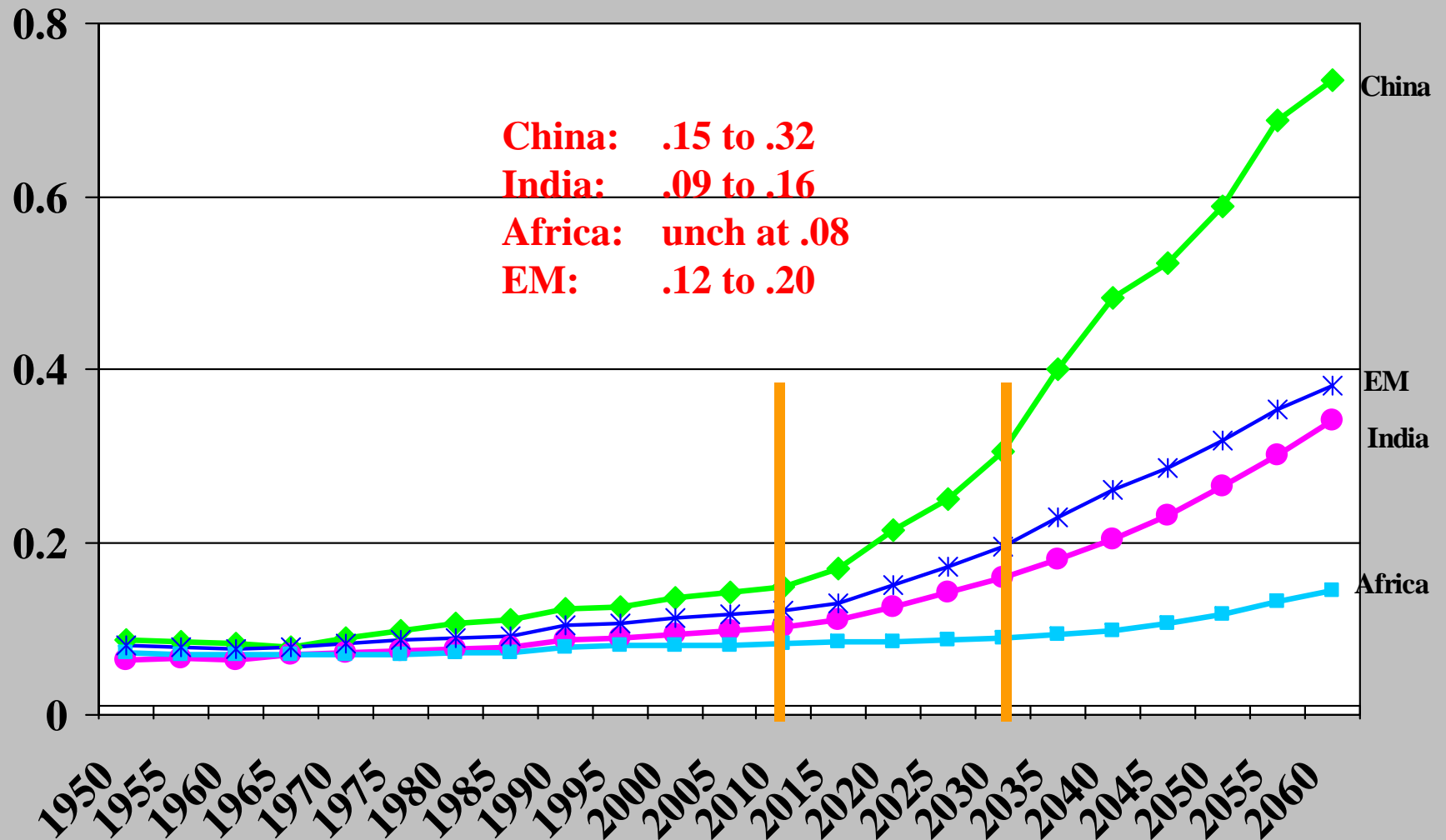
Rising Life Expectancy and Declining Retirement Age



Different Demographics in EM

- The rest of the world, even China is much younger than the US.
- Over next 20 years the Emerging Economies will experience a much smaller increase in the number of retirees per worker.
- Look at demographics

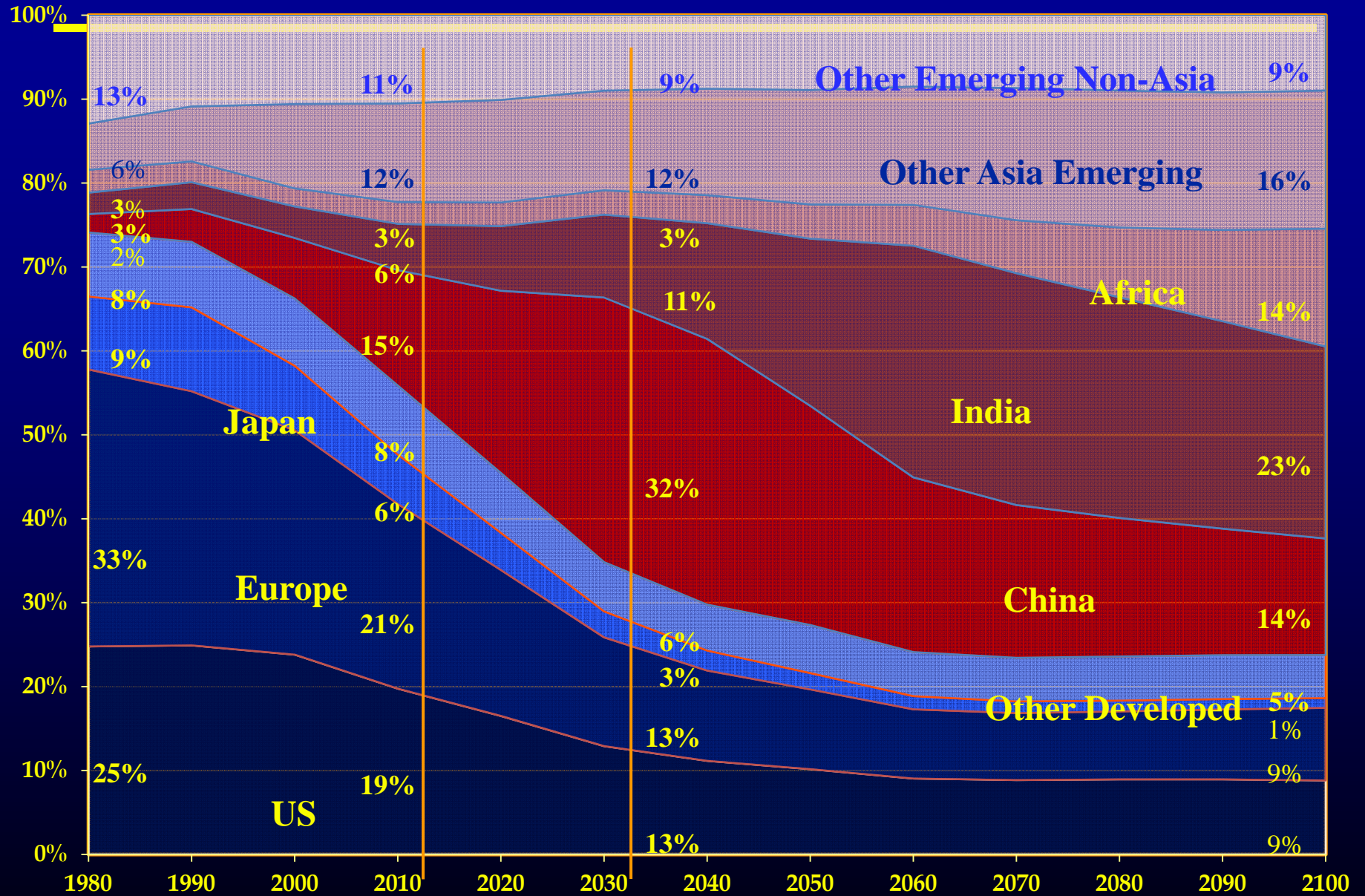
Ratio of Retirees (Age 65+) to workers (Age 20-64)



Distribution of World GDP

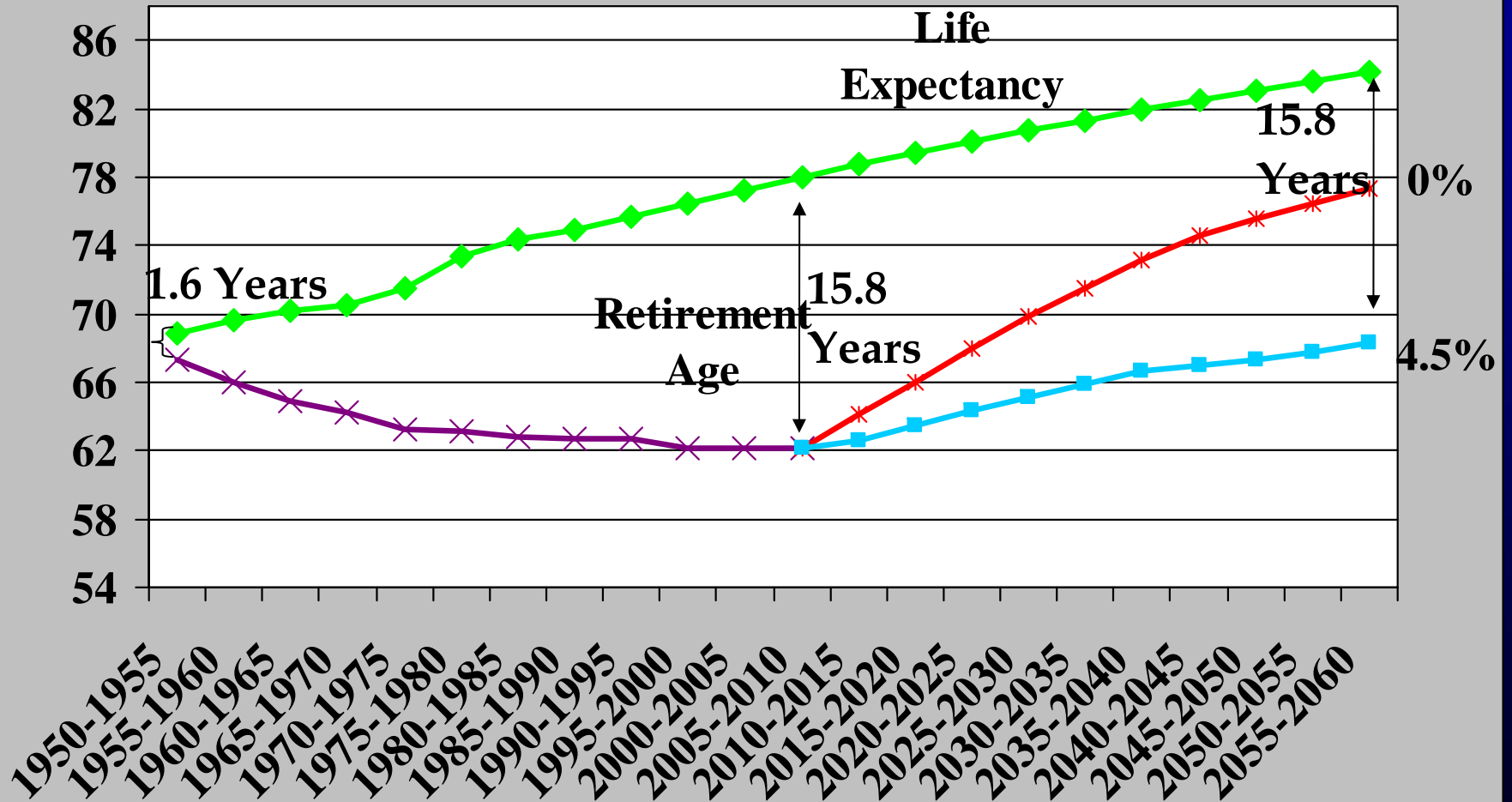
- Given current trends, the distribution of output around the world is going to change radically over the next twenty years.

World GDP



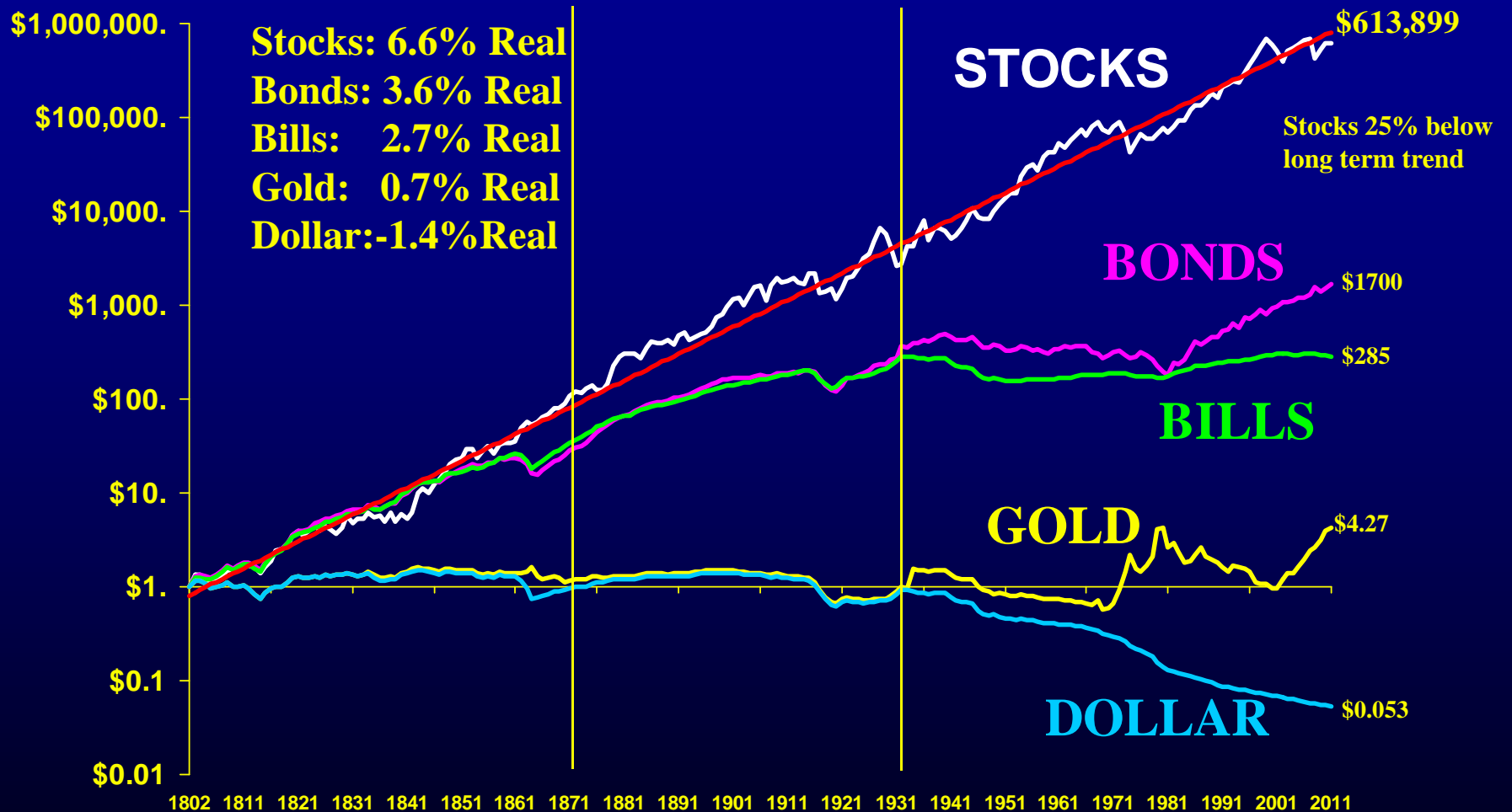
Retirement Age against GDP growth in LDCs

U.S. Life Expectancy and Retirement Age



Total Real Return Indexes

January 1802 – December 2011



Source: Siegel, Jeremy, *Future for Investors* (2005), *With Updates to 2011*

Past performance is not indicative of future results.

Important Information

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Risks

Note: Stocks are typically subject to increased risks compared to U.S. Treasury Bills while bonds are subject to adverse consequences associated with rising interest rates that cause a decline in a bond's price. A U.S. treasury bill has less risk than bonds because of its very short-term nature and the U.S. government is considered a good creditor. Gold is often invested in as a hedge for inflation, but there is market risk that gold prices fluctuate widely. The value of the U.S. dollar depreciates over time with inflation, so the primary risk is inflation risk.

Important Information

You cannot invest directly in an Index. Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the Index. Index performance assumes reinvestment of dividends, but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in Fund shares. Such fees, expenses and commissions could reduce returns.

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The S&P 500 Price/ earnings ratio is defined as the S&P 500's net income per share divided by its index level. The S&P 500 Index is a capitalization-weighted index of 500 stocks selected by the Standard & Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

NASDAQ is a computerized system established by the FINRA to facilitate trading by providing broker/dealers with current bid and ask price quotes on over-the-counter stocks and some listed stocks.

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