

Is This the Future of the Stock Market?

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Jeremy Grantham, an investment advisor often quoted by John Mauldin in his weekly e-mail newsletter, recently made his 7-year forecast of stock market total returns. To say the very least, the forecast makes for worrisome reading. Particularly worrisome, in our mind, is that we believe his forward valuations (see future column in the first table) are too optimistic. According to Jeremy, one will probably obtain negative returns over the next seven years (note bottom of second table). The interesting thing is that the only way positive real returns can be achieved under this scenario is for there to be deflation. Inflation will make it even worse.

Obviously, no one knows for sure the future but a hundred years of history tells us that this is quite possible. We continue to believe that one should deemphasize common stocks in one's portfolio. It's still not too late to make the change to U.S. government bonds.

Next Seven Years Jeremy Grantham

<u>Critical Items</u>	<u>Today</u>	<u>Historical</u>	<u>Future</u>
P/E Ratio	22x	14x	16x
Real Sales	2.0%	1.8%	2.9%
Real Dividends	1.7%	3.0%	2.3%
Profit Margins	7.0%	4.9%	6.0%

Mathematical Computations

Real Sales	+2.9%
Real Dividends	+2.3%
Profit Margin	-2.8%
Reduction in P/E	-4.5%
Annual Total Return	-2.1%

Example: going from nominal to real returns.

Nominal	-2.1%	Nominal	-2.1%
Deflation	<u>+3.1%</u>	Inflation	<u>-3.1%</u>
Real	+1.0%	Real	-5.2%