Stocks vs. Bonds: A Decade of Record Disparity

Among the many market anomalies resulting from last year's global financial crisis and stocks' abysmal performance over the past decade is the gaping disparity between stock and bond returns.

The chart on this page illustrates the striking performance differential between the annualized return of the S&P 500 Stock Index and 10-year Treasury bonds over rolling 10-year periods (measured on a quarterly basis), starting with the period ended 1926. Stocks are generally more risky and volatile investments than bonds, but their 10-year return has exceeded that of Treasury bonds in 85% of these periods, according to The Leuthold Group, a market research firm.

However, for the decade ended March 31, 2009, stocks underperformed bonds by a record differential in annualized returns of 9.8 percentage points. During that decade, the S&P 500 had an annualized return of -3.0%.

Stocks also lagged bonds during the 20 years ended March 31, marking only the third 20-year period that this has occurred since 1926.

"This goes a long way to explain why confidence in the stock market has been so difficult to rebuild, especially among individual investors," says Eric Bjorgen, a senior research analyst with Leuthold.

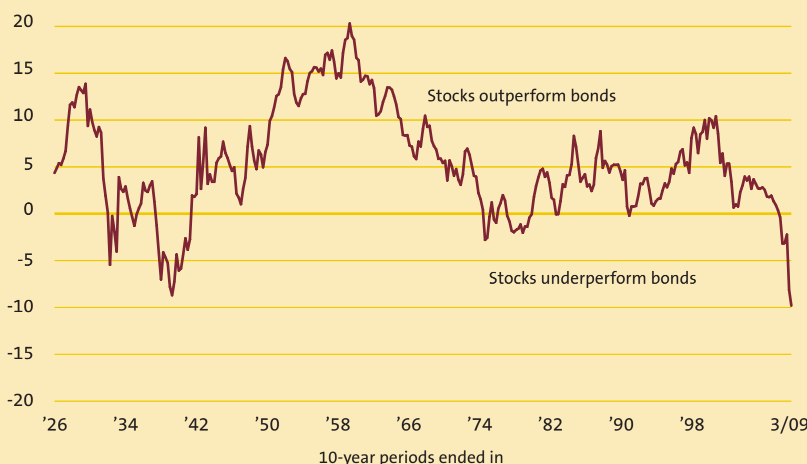
A Perfect Storm

Of course, the past decade was a perfect storm for equity investing, beginning with record valuations in early 1999, particularly for technology stocks, and featuring the two worst bear markets since the Great Depression—with the latter bear market causing a flight to quality that pushed Treasury yields to record lows.

Because the past decade has been so bad, Leuthold notes that the stock-versus-bond total return differential was at or near all-time lows over the 20-, 25-, 30-, 35-, and 40-year periods as of March 31, 2009, challenging the widely held view that stocks outperform over the long run.

Stock/Bond Performance: Difference in Annualized Return of S&P 500 Stock Index and 10-Year Treasury Bonds Over Rolling 10-Year Periods

Percentage Point Difference in 10-Year Annualized Return



Past performance cannot guarantee future results. The S&P 500 Index tracks the stocks of 500 U.S. companies. It is not possible to invest directly in an index.
Source: The Leuthold Group.

While this historical performance may discourage equity investors, it also may signal a rare opportunity to shift some assets from bonds to stocks. As reflected in the chart below, on the rare occasions when the stock/bond performance differential turned negative, the stock market was bottoming and significant equity outperformance followed.

Leuthold notes that after the differential hit a low in the second quarter of 1932, for example, stocks achieved an annualized return of 33.8% over the next five years compared with 4.6% for bonds. After the other 20-year period when bonds outperformed, ended in the third quarter of 1949, the S&P 500 gained 23.1% annually over the subsequent five years; this compares with only 1.6% for 10-year Treasuries.

Mr. Bjorgen concludes, "From a variety of vantage points, the table appears to be set for equities to substantially outperform fixed income over the next several years."

T. Rowe Price bond managers agree. "I would not expect the bond outperformance we saw over the last decade to continue," says Steven Huber, manager of the firm's Strategic Income Fund. "Treasury yields were much higher 10 years ago than where they are today, so there is not a lot of upside [for capital appreciation] from here, though we do see upside in some other sectors of the fixed-income market."

The expected reversal in stock/bond relative performance may have already begun. In the second quarter, the S&P 500 rose 15.9% compared with a -6.2% return for 10-year Treasuries as equities staged one of their most powerful rallies since the 1930s.

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