

By E.S. BROWNING

As stocks plunged last week, investors focused on the risk of recession and another market collapse.

Richard Sylla sees something very different over the longer term: the much-longer term.

Click on this link to view the interview:

<http://online.wsj.com/article/SB10001424053111904103404576563740777749536.html?KEYWORDS=a+long-term+case+for+stocks>



Richard Sylla, economic historian and professor of economics at New York University's Stern School of Business, talks with WSJ's E.S. Browning about his formula for predicting market performance.

Prof. Sylla is a financial historian at New York University's Stern School of Business, studying market behavior all the way back to 1790. By analyzing patterns detected years ago with two colleagues, he accurately predicted in 2000 the decade of overall declines that haunted investors.

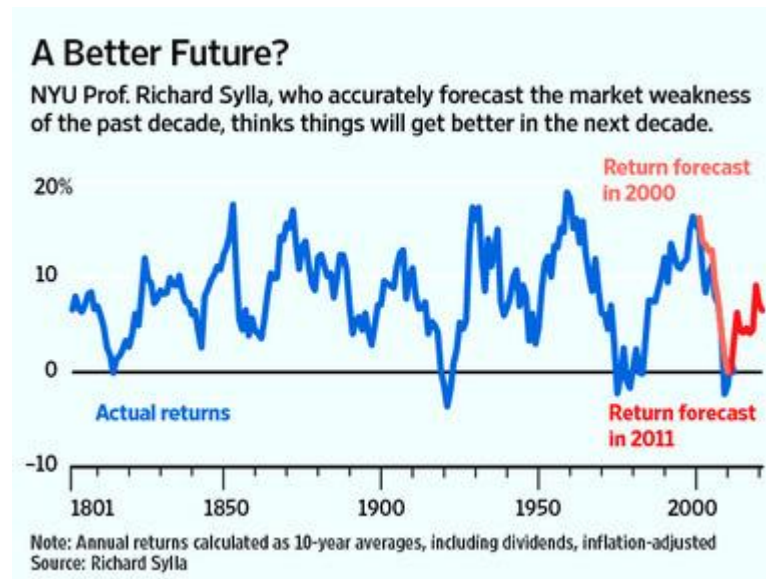
Now, Prof. Sylla has made a new forecast at the request of The Wall Street Journal. Better days lie ahead, he says. If past market patterns hold true, as they did in the last decade, stocks should bottom out during the next few years and begin a recovery.

"People ought to take a longer view and think in terms of years and even decades," Prof. Sylla says. "Most people are quite pessimistic right now. I am saying: The market may go down from here. It may go up. But if you look at the long sweep of history, this seems like a good time to buy because the average return is down near the bottom" and is likely to go up.

Last week, the Dow Jones Industrial Average fell 2.2% to 10992.13. If the market sticks to its long-term pattern, Prof. Sylla says, the Dow Jones Industrial Average could climb to 20250 by the end of 2020, up 84% from today. The Standard & Poor's 500-stock index might hit 2300, up 99% from Friday's close of 1154.23.

Prof. Sylla isn't trying to predict short-term behavior. He doesn't know whether stocks will be higher or lower at year end, and he isn't losing sleep over Greece, the sputtering U.S. economy or other problems now haunting stocks.

His long-run focus parallels that of financial planners, many of whom urge clients who aren't about to retire to tune out the stock market's volatile swings.



"Not that you want to be unaware of what is happening day-to-day, but to have to worry about reacting to what is going on when you are not going to be using this money for 20 years is kind of silly," says Reed Rinderknecht, a financial planner at Foster Group in West Des Moines, Iowa. More than 90% of the firm's clients "understand that and are able to go back to work and not worry about what is going on," he says.

Using 10-year averages of annual market returns, including dividends and adjusted for inflation, Prof. Sylla and his colleagues found that U.S. stocks have risen and fallen in surprisingly consistent waves for more than 200 years. The pattern has become even steadier since World War II.

When 10-year-average annual returns dip below 5% and especially when they turn negative, as they did in 2008 and 2009, markets tend to bottom out and begin a recovery, the figures show. Years later, returns top out as investors get overconfident, with average returns above 15%. The market patterns might be related to swings of economic performance and investor confidence.

In 2000, when returns were at the high end of his range, Prof. Sylla found that a decade of zero average annual returns would fit the past trend. He was right, and stocks suffered.



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Now a recovery with 6.5% average annual returns, equal to the historical inflation-adjusted average, would fit, he says. He isn't saying stocks will rise that much each year, just that this could be the average.

Prof. Sylla does see a 25% chance that the next decade could fall well short of that. Japan suffered meager stock returns for more than 20 years after its real-estate and stock bubbles burst in 1990. Still, "my guess is that even if we had a couple more years of bouncing around, 2013 to 2022 would be much better," he says.

Investors with long time horizons should focus on where stocks could be in 10, 20 or even 30 years, Prof. Sylla says. That doesn't mean they should buy stocks to the exclusion of all else, just that they shouldn't give up on them.

"There is a lot of excessive short-term thinking about the stock market: 'What did [Federal Reserve Chairman Ben] Bernanke say today?' " he says. "In the 1980s, it looked terrible with those low returns, but I always tell my students that wasn't such a bad time to buy stocks."

Prof. Sylla based his work on the S&P 500, for which data have been estimated back to 1871, as well as calculations he did with his two colleagues for the period from 1790 to 1860, and the work of Bryan Taylor of Global Financial Data for the intervening period.



Reuters

Prof. Richard Sylla, shown in 2008, says he believes the U.S. 'is going to recover and go on to prosperity again as it always has.'

The reason business and stock cycles were shorter and more volatile before World War II is probably that stocks were focused then on the growing industrial economy, he says. Since then, they have tracked the growing service economy, which tends to be less volatile. In addition, stock returns during the 19th century came mainly from dividends. Now, price gains provide most of the fuel.

Of course, stocks could lurch higher and lower in the short run. And things could get worse before they get better. Prof. Sylla says the current period resembles a downturn period in the late 19th century.

"We may not be able to get enlightened government policies until things get worse than they are now, which isn't a happy thought," he says. But in the longer run, "I think the country is going to recover and go on to prosperity again as it always has."

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