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Lost Decade wasn't so bad for serious investors

Those who diversified fared well despite crash

Michael Nairne, Serious Money

Decade	Value of $1,000 initial investment at the end of the decade*
1930-1939	$995
1940-1949	$2,405
1950-1959	$5,865
1960-1969	$2,121
1970-1979	$1,767
[illegible]	[illegible]

The Lost Decade. Computations By Tacita Capital, National Post

It's being called the Lost Decade -- a dismal 10-year stretch from 2000 to 2009, when the average owner of U.S. stocks lost money. If US$1,000 was invested in the S&P 500 on the first day of the new millennium, it was worth only US$909 on Dec. 31, 2009, equating to a loss of -1.0% a year.

Sadly, this was the worst performance in the past eight decades, surpassing even the bleak 1930s Depression era.

In retrospect, the ludicrously high valuation of stocks spawned by the tech mania created a decade that was bound to disappoint. The cataclysmic bursting of the credit bubble in 2008 was the coup de grace for U.S. stock prices.

Canadian investors in the U.S. market did even worse as the appreciating Canadian dollar added to these losses.

The decade, however, was not lost to serious investors. They refused to get caught up with the euphoria of the tech boom and maintained sizeable allocations to the "energy and materials-laden" Canadian stock market.

Although this was a very unfashionable view at the turn of the millennium, it paid off.

The S&P/TSX composite index managed to grind out a comparatively respectable 5.6% annual return over the past decade.

Many high-net-worth investors did much better. Was this luck or skill? The evidence is illuminating.

A survey of millionaires by Northern Trust found that when affluent investors have a preference, they tend to buy value stocks over growth stocks.

Value stocks in Canada as measured by the performance of the MSCI Canada Value index, enjoyed a robust 9.5% annual return over the past 10 years. Even in the United States, value stocks managed to eke out a positive return.

High-net-worth investors also typically allocate a portion of their portfolio to stocks of smaller companies. In Canada, according to the MSCI Small Cap index, the annual return was 8.5% over the past decade. Small-company stock returns exceeded those of large companies in the United States and internationally as well.

There is considerable historic evidence and academic support for the view that value and small-company stocks will outperform the broad market over the long run. Serious investors pay attention to empirical findings. Two of the top independent wealth-management firms in the United States construct portfolios with incremental weightings to value and small-company stocks.

High-net-worth families also diversify more broadly by incorporating real estate, commodities and alternative investments into their portfolios.

Despite painful losses in 2008, Canadian real estate investment trusts (REITs) enjoyed stellar returns over the past decade with a 13.1% annual return; Canadian investors in U.S. REITs realized a 7.1% annual return.

On the commodity front, gold bullion achieved a return of 11% per annum, while the price of oil climbed 8.2% per annum.

And hedge funds actually hedged -- the CS Tremont Hedge Fund index was up 6.6% per annum over the past decade.

In reality, this decade was lost only to those investors who fell under the spell of "new-era" delusions. Serious investors who diversified broadly across asset classes and made judicious allocations to value and small-cap stocks did just fine.

Investors today who are increasingly concentrated in gold and commodities should take note.

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