OCTOBER 2012

The Key to Long-Term Success: The Income Component of Returns

During the last two decades of the twentieth century, the investing world saw declining dividend and bond yields, while prices for both equities and bonds rose. In the early years of this century, investors seemed to belittle the importance of income as a component of returns, focusing primarily on the potential for capital gains. In this paper, The Brandes Institute investigates income's role as a component of total returns based on 86 years of financial asset performance.

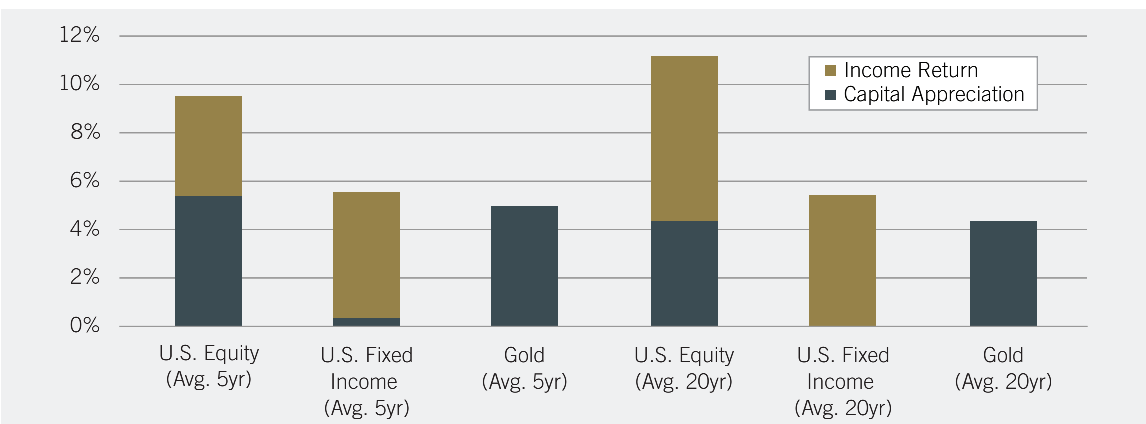
Methodology:

To examine the impact of the division of income and capital appreciation returns, we analyze equity and fixed income series in the United States and the United Kingdom, as well as gold bullion (a non-income producing asset for comparison) over the 1926-2011 period.

Key Findings:

Our review revealed that income was a significant component of returns for all long-term periods. For U.S. equities, income represented 44% and 61% of returns for 5 and 20-year rolling periods respectively. Exhibit 1 shows that the longer the investor's horizon, the greater the impact.

Exhibit 1: Income and Capital Components of Annualized Returns over 5- and 20-year Rolling Periods, 1926-2011 (U.S. dollar-based comparison of U.S. equity and fixed income versus gold)



Sources: Brandes Institute, based on data from Ibbotson Associates, Global Financial Data, Inc. and FactSet, as of December 31, 2011.
Past performance is not a guarantee of future results.

The study also revealed:

- For periods of more than 10 years, the income component surpassed capital appreciation and represented the bulk of returns generated in all income-producing asset classes.
- The income component dominated fixed income returns for all time horizons longer than five years.
- U.K. financial assets demonstrated substantially the same characteristics as their U.S. counterparts.

Data Sources

U.S. Equity
S& P 500 Index (S&P 500 Index, 1976-2011; 500 largest U.S. stocks in market value, 1957-1976; 90 largest stocks, U.S. market value, 1926-1957) through Ibbotson Associates
S&P 500 Index Dividend Yield (for Yield Gap exhibits) through mutpl.com

U.S. Fixed Income
Long-term government (10-year) Bond Series (Wall Street Journal, 1977-present; Center for Research in Security Prices (CRSP), 1926-1976) through Ibbotson Associates

Gold
Gold Spot Price, London PM Fixing (US$/ounce), 1926-2011, Global Financial Data, Inc. and FactSet

Disclosures

The S&P 500 Index with gross dividends is an unmanaged, market capitalization weighted index that measures the equity performance of 500 leading companies in leading industries of the U.S. economy. The index includes 500 leading companies in leading industries of the U.S. economy, capturing 75% coverage of U.S. equities. This index includes dividends and distributions, but does not reflect fees, brokerage commissions, withholding taxes, or other expenses of investing.

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