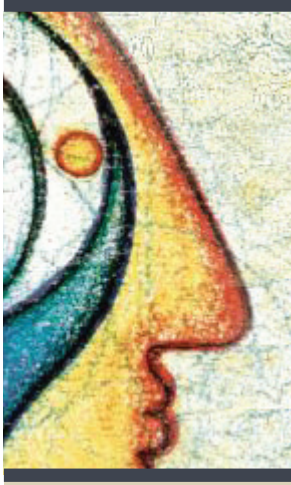


ORIGINAL RESEARCH
FOR INQUISITIVE INVESTORS

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

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I. Executive Summary

During the last two decades of the twentieth century, the investing world saw declining dividend and bond yields, with prices generally moving higher for both equities and bonds over the period. 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 2004, the Brandes Institute published “Examining the Income Component of Total Returns,” which analyzed public market data as far back as 1926 to evaluate the impact income had on total returns. In the eight years since our original study, bond yields globally have continued to decline and equity dividend yields have moved above bond yields in a number of countries. In this update, we expand our original findings and focus on today’s investment environment.

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 (a span of 86 years).

Based on the updated data through 2011, the long-term data showed that income was a significant component of returns for financial assets for all long-term periods.

Our research found:

- The income component of fixed income returns generally represented 9/10th of returns for periods as short as five years.
- The income component of equity returns became larger than capital appreciation at a 10-year horizon, and then increasingly dominant as time horizons were extended.
- U.K. financial assets demonstrated the same income return characteristics as their U.S. counterparts.
- Gold’s long-term total returns fell far short of U.S. equities, but modestly exceeded those of U.S. bonds.

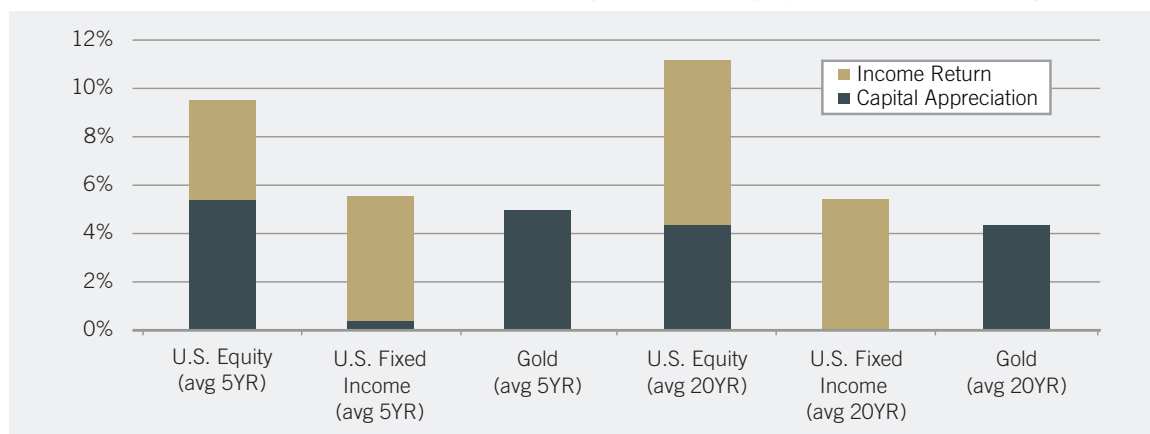
For U.S. dollar based investors, this income component analysis demonstrates a very clear choice between three distinct asset classes:

- No income, all capital: Gold (100% of long-term return is capital)
- Primarily income: bonds (over 95% of total return comes from income for rolling periods of 10 years or more)
- Mixed: Equity (both income and capital contribute materially to long-term returns)

Exhibit 1, on the following page, shows the importance of the income component in long-term returns, and how the longer the investor’s horizon, the greater the impact.

For the first time since the 1960s, bond yields have dropped below equity dividend yields, eliminating the reverse yield gap that has defined the prevailing investment environment.

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)



Source: 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.

II. Background

Almost a decade ago, we published our original research on the income component of total returns in conjunction with Professor Elroy Dimson of the London Business School. Dividend yields in the United States had declined over the prior decade, a period including the recent memory of the tech bubble. Our paper was a reminder for investors that investing is not all about capital gains and losses, but that long-term success has depended substantially on the income component.

Eight years later, the continued decline in bond yields, the stagnation of equity markets, and the resurgence of the gold price have each had a marked impact on investor sentiment. Income investing has picked up supporters among both individual and institutional investors.

We think it's the right time to publish an update of the work we did in 2004. One goal of this paper is not just to update the statistics, but also to re-examine the role of income investing in an environment with 10-year U.S. Treasury yields now under 2%. This is literally an unprecedented situation in the United States.¹

In addition, for the first time since the 1960s bond yields have dropped below equity dividend yields, eliminating the reverse yield gap that has defined the prevailing investment environment.

In the United States the impact is small; however, in Europe the impact is more pronounced. We look at this in greater detail by examining financial data from the United Kingdom, which has the same breadth and duration as the U.S. sample set.

III. Methodology

One factor that has historically led investors to underestimate the impact of income has been a reluctance to consider a true long-term horizon. Often, references to long-term investment performance tend to cite 3- or 5-year asset class returns. We challenge this definition of a long-term horizon for two reasons. First, individuals and institutions may be investing for retirement purposes or with liability needs that have a horizon of 20 years or more. Second, the characteristics of investment returns may change significantly if long term is redefined from five years to 20 years or more. While our data would allow even longer horizons than 20 years, we consider that length of period to be a reasonable practical maximum for most institutional and individual investors.

For reference, all return series measure accumulated returns assuming an initial investment of \$100 in the United States or £100 for the United Kingdom.² The primary method of

¹ "To strive, to seek, to find, and not to yield: The remarkable demand for low-yielding government bonds." *The Economist*, June 30, 2012.

² We used two return series: a total return series that included the reinvestment of dividends and capital gains distributions and one that was capital appreciation only. We calculated the income component of returns by subtracting the capital appreciation only series from the total return series. Neither series reflects considerations for taxes, fees or other expenses.

Historically, low bond yields worldwide have led many commentators to construct their forecasts around how far bond yields will rise, and when this rise will start.

analysis measures results over a period using rolling windows (e.g., five or 20 years) from the starting date of the series, then advances one year and repeats the process until the whole data set is included.³ These results are then averaged across the whole period. This analytical approach allows us to gain insight into the relative importance of the capital appreciation and income components within the total return series. The accompanying charts include data provided by Ibbotson Associates, Global Financial Data, Inc. and FactSet.

IV. The Importance of Income in Today's Investment Environment

Historically, low bond yields worldwide have led many commentators to construct their forecasts around how far bond yields will rise, and when this rise will start. We are not forecasters and in this paper do not take a view on the timing and characteristics of any future bond bear market. However, it may be instructive to look at the effect of the income component within the last extended period of rising bond yields, the three decades from the early 1950s to 1980.

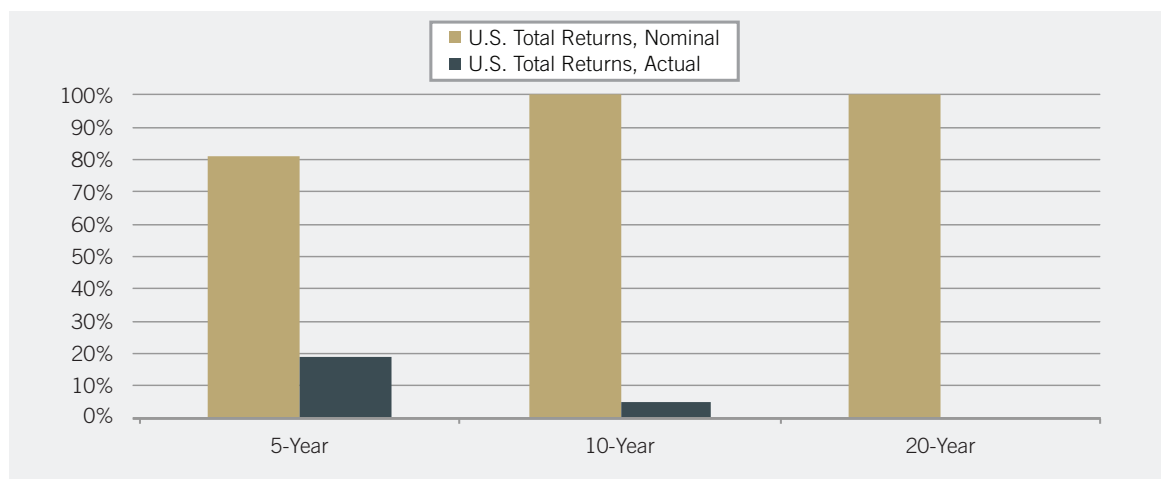
The impact of income in a future long-term bear market for bonds

By definition, in a bond bear market, yields are rising so the capital prices of bonds are falling. So it should not be surprising that over long periods capital returns on bonds are negative. Of all the 10-calendar-year rolling periods in that era (starting with January 1951 to December 1960, and ending with January 1971 to December 1980) there was not a single one where capital returns were positive. Yet the income component was powerful enough that every one of those same rolling 10-year periods provided positive total returns.

However, that's where the good news stops. Bond investors should also factor in the impact of inflation on long-term returns. Calculating real returns after inflation changes the picture significantly. Positive nominal returns generally turned into negative real returns after adjusting for inflation, especially at longer horizons.

Exhibit 2 shows the frequency of positive relative to negative returns over different rolling periods. The income component of returns may allow investors to achieve positive nominal returns in a bond bear market, but historically has not provided protection for real returns.

Exhibit 2: Proportion of Periods with Positive Long-Term Returns During Bond Bear Market
(Rolling calendar year periods, January 1951 to December 1980)



Source: 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.

³Returns for rolling windows are annualized returns for a series of overlapping, smaller time periods within a single, larger time period. For example, the 20-year time period from 12/31/82 through 12/31/02 consists of 16 five-year segments. The first segment is the five-year period 12/31/82-12/31/87, the next segment is the five-year period 12/31/83-12/31/88, and so on.

The Dividend Yield Gap

The yield gap between equities and bonds provides a good example of enduring long-term trends. Prior to the 1960s, government bond yields were generally lower than dividend yields on equities, attributed to the notion that equities were riskier and hence should provide a higher yield. In the late 1950s, bond yields started to rise. In hindsight, this was the start of the bond bear market that lasted until the early 1980s. While bond yields rose, the dividend yield on equities stayed relatively steady over the following decades, with any increases much more muted than those of bond yields.

This reversal of the yield gap was generally attributed to the argument that equities provided growth in both capital and income, and hence investors could be satisfied with a lower yield at the outset, given the potential for long-term growth. The reverse yield gap could be said to have underpinned the evolution of the asset management industry toward equities in a broad context.

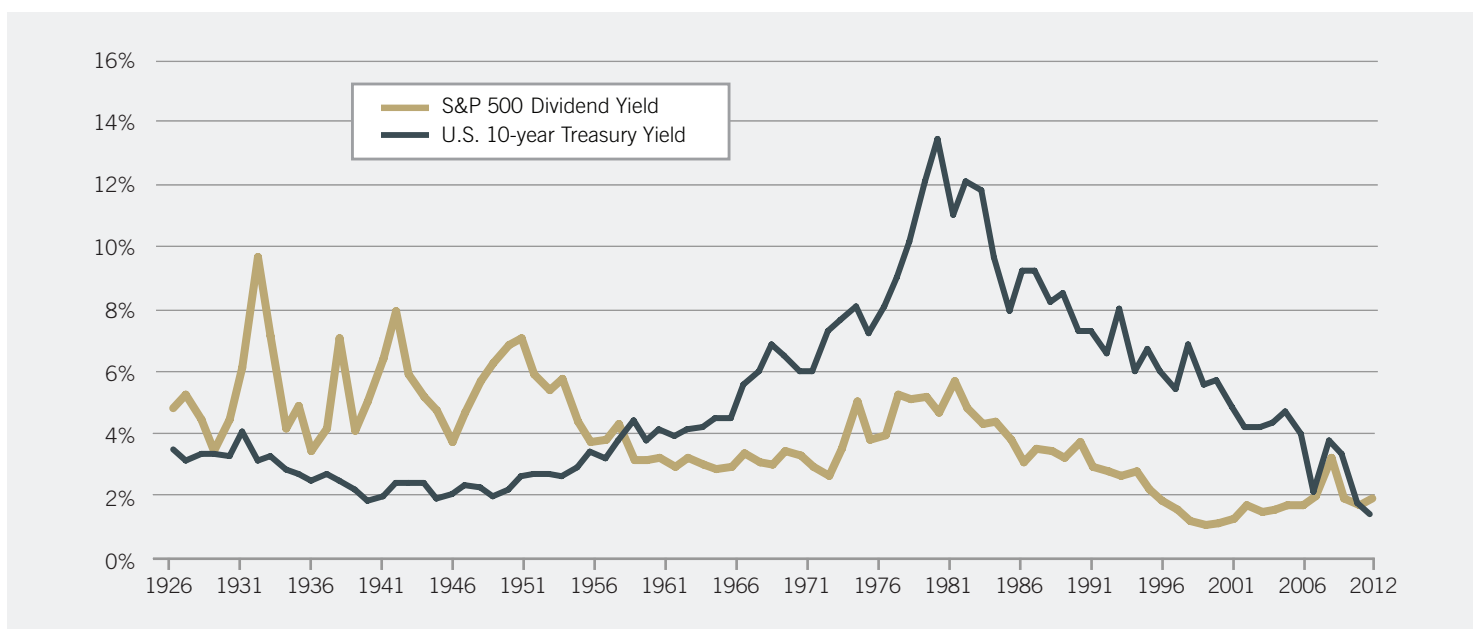
Since the financial crisis of 2008, the drop in bond yields narrowed and eventually eliminated the reverse yield gap in the United States. For equities, a decade of stagnant prices coupled with rising dividends has approximately doubled the average dividend yield from just over 1% in 2001 to around 2% by mid-2012. This may seem like quibbling over modest changes in what are now small numbers, but putting this in a global context is more revealing.

While we lack extensive back-data on most other major markets, looking at the yield gaps today in world markets reveals that the United States has one of the smallest positive yield gaps. The yield gap in the United Kingdom had expanded to 2.3% by mid-2012. Japan, with a history of low dividend yields, now has a yield gap close to 2%. In continental Europe, setting aside the more volatile markets affected by the euro-crisis (e.g., Italy and Spain), Germany is notable for having a yield gap over 2.5%.

A decade of stagnant prices coupled with rising dividends has approximately doubled the average dividend yield from just over 1% in 2001 to around 2% by mid-2012.

Exhibit 3: The U.S. Dividend Yield Gap, 1926-2012

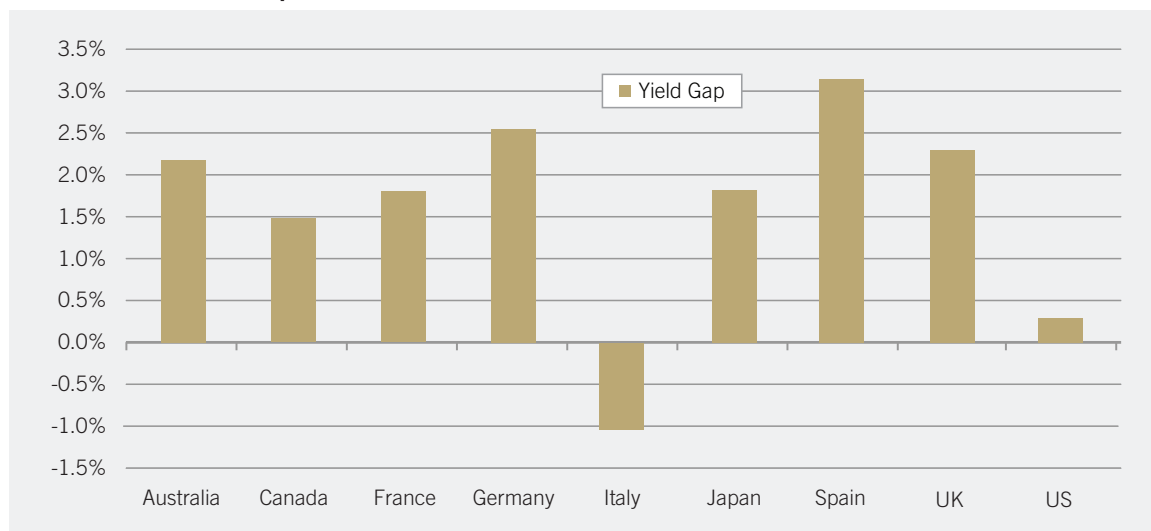
The Dividend Yield for U.S. Stocks Has Climbed Above the Yield for Long-Term U.S. Treasury Bonds



Source: Brandes Institute, based on data from Ibbotson Associates, Global Financial Data, Inc and FactSet, as of July 31, 2012. Past performance is not a guarantee of future results.

As equity performance worldwide has lagged bonds over recent years, it's not surprising that investors, particularly those with short-term focus, have reallocated toward bonds and other asset classes.

Exhibit 4: The Yield Gaps* Around the World



Source: Brandes Institute via FactSet, as of June 30, 2012. Past performance is not a guarantee of future results.

*The yield gap is defined as the dividend yield on stocks minus the yield on government bonds.

A key question for investors (particularly those with a global perspective) is whether the elimination of the reverse yield gap recently is just a statistical anomaly, or might it signify a change in the investment environment as momentous as the "cult of equity" that started in the 1960s?

As equity performance worldwide has lagged bonds over recent years, it's not surprising that investors, particularly those with short-term focus, have reallocated toward bonds and other asset classes. The last decade has cost the cult of equity a lot of disciples.

Longer-term focused institutional investors such as pension funds also have reduced equity exposure. While some of this may also be related to recent equity performance, another significant influence has been the goal of reducing asset-liability mismatches through LDI (Liability-Driven Investing). However, future income streams locked in by LDI strategies are falling increasingly short of the returns needed to match liabilities. The Financial Times' FTFM (Financial Times Fund Management) August 2012 monthly review noted that both U.S. and U.K. pension funds have been awarding equity income mandates with higher frequency in order to make up for the lower income available from bonds. The analysis notes that low bond yields provide incentive to "reverse the industry's decades-long rush out of equities and into fixed income."⁴

Given this we can make some observations about possible investment scenarios over the next decade:

- **Scenario 1:** bond yields stay low, or go even lower (the "Japan syndrome"). Most commentators give this a relatively low probability. In a low-growth, low-inflation environment, equity prices may fall and dividends may be reduced; however, dividend yields would not decline unless dividends fall faster than prices. In this scenario, dividend yields may stay above bond yields, keeping the yield gap positive.
- **Scenario 2:** bond yields gradually rise, but stay within the lower end of historic ranges for an extended period. This is many commentators' hope, typically with a moderate growth, moderate inflation outlook. Embedded in this scenario may be an assumption that markets go back to business as usual with investment ratios reverting to the norms and ranges that were typical before 2008. In the United States, and maybe elsewhere, this would likely see a return to the reverse yield gap.

⁴Redgrave, James. "Pensions Turn Back to Stocks for Income." *The Financial Times*, August 5, 2012.

- **Scenario 3:** bond yields rise fast at some point, possibly associated with increased inflationary pressures. The history of the 1970s suggests this might be a difficult environment for equities (and by definition for bonds). The yield gap would likely reverse in this scenario; however, the driving force might not be a return to the cult of equity, but a market environment of high volatility and intermittent panics.

While we are not forecasting the likelihood of any of these scenarios, our research suggests that in any situation, long-term investors should benefit from the income component in their equity portfolios.

The Equity Risk Premium

A central element in determining allocations between equity and fixed income is the Equity Risk Premium (ERP), the long-term equity return above risk-free bonds. This can be viewed both in historic context (similarly to how the income component of returns is analyzed in this research) and prospectively to determine an estimated ERP for investment decisions.

With equity dividend yields now above bond yields, the ERP is especially relevant to a study of the income component and its implications for investors. An excellent synopsis of the views of leading practitioners and academics on the ERP was recently published by the CFA Institute. “Rethinking the Equity Risk Premium” is an update of a project dating back to 2001, which analyzes ERP from both historic and forward-looking perspectives. While the publication includes 11 articles, all of which are worth reading, there are two particularly relevant to the study of the income component of returns.

First, from the historic perspective, “Equity Premiums around the World” by Professors Dimson, Marsh and Staunton covers 111 years of data across 19 countries. (Professor Dimson co-authored the original 2004 Brandes Institute research on the income component). The article provides breakdowns of the ERP for each country, but the most relevant for our purposes are the ERP breakdowns for U.S. investors in domestic markets and across the worldwide aggregate.

Exhibit 5: Five Elements of the Equity Risk Premium, 1900–2010, U.S. \$ Based

	U.S.	World
Dividend Yield*	4.2%	4.1%
+ Real Dividend Growth Rate	1.4%	0.8%
+ Expansion in P/E	0.6%	0.5%
+ Change in Real Exchange Rate	0.0%	0.0%
- U.S. Real Interest Rate	1.0%	1.0%
= ERP for U.S. Investors	5.2%	4.4%

Source: Dimson, Marsh and Staunton, “Equity Premiums Around the World” in CFA Institute’s Equity Risk Premium 2011, as summarized in *InvestorLit* 2012. Past performance is not a guarantee of future results.

*geometric mean dividend yield

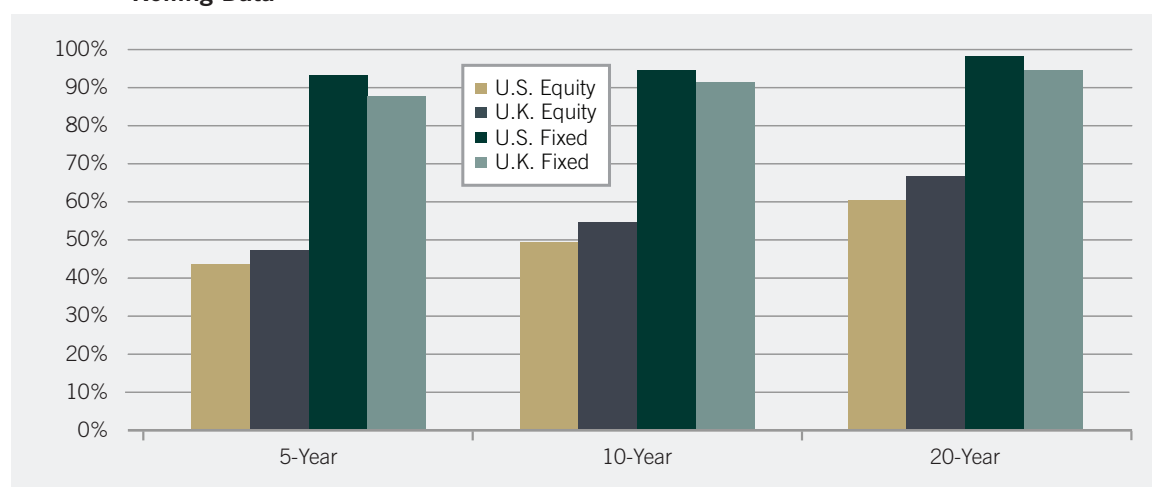
Exhibit 5 demonstrates the importance of dividend yield from the historic perspective. As noted previously, equity dividend yields are still well below the long-term average. However, they are now above bond yields, which are the focus of the second article of particular interest: “Will Bonds Outperform Stocks over the Long Run? Not Likely” by Peng Chen (a longtime colleague of Roger Ibbotson, who also has an article in the same CFA Institute publication). This article takes a forward-looking perspective, noting the low levels of bond yields currently, and estimating the ERP to be around 3.3% over the next 20 years.

The range of estimated ERP numbers in the CFA compilation of academics and practitioners ranges from 3% to 6%, with the consensus around 4%. Given the dominating influence of dividend yield in the past, this appears consistent with the importance of the income component of returns continuing in the future.

For truly long-term investors who believe that equity dividends will grow over time, this suggests a good chance of success for an investment approach built on wealth-producing, dividend-paying companies. The caveat is that investors who are overly concerned about short-term price volatility (e.g., for periods under five years) will likely not stay with the approach and may not reap the potential long-term benefits.

V. Long-Term Components of Return Summarized

Exhibit 6: Average Income Component of Returns Percentages from 5-, 10-, and 20-Year Rolling Data



Source: 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.

Based on our review of 86 years of U.S. and U.K. investment returns across equity and fixed income, the importance of income's contribution to total returns is clear.

- Fixed income returns were dominated by the income component for all time horizons longer than five years.
- For equities, the income component became larger than capital appreciation for horizons of 10 years and longer.
- For periods of more than 10 years, the income component was dominant over capital appreciation and represented the bulk of returns generated in all income-producing asset classes.
- U.K. financial assets demonstrated substantially the same characteristics as their U.S. counterparts with regard to the importance of income in returns.

We believe this research illustrates that the industry acceptance of five years as a long-term investment horizon underestimates the potential of reinvesting and compounding income. By reinvesting the income contribution of investment returns, investors leverage the power of compound interest. Investors should not let recent market experience distort their perspective, and particularly should avoid preconceptions of income's contribution to equity returns. Income has served as a significant component of returns, and the combination of reinvested income and capital appreciation historically has presented the best option for long-term investors to realize optimal returns.

APPENDIX

I. U.S. Asset Classes

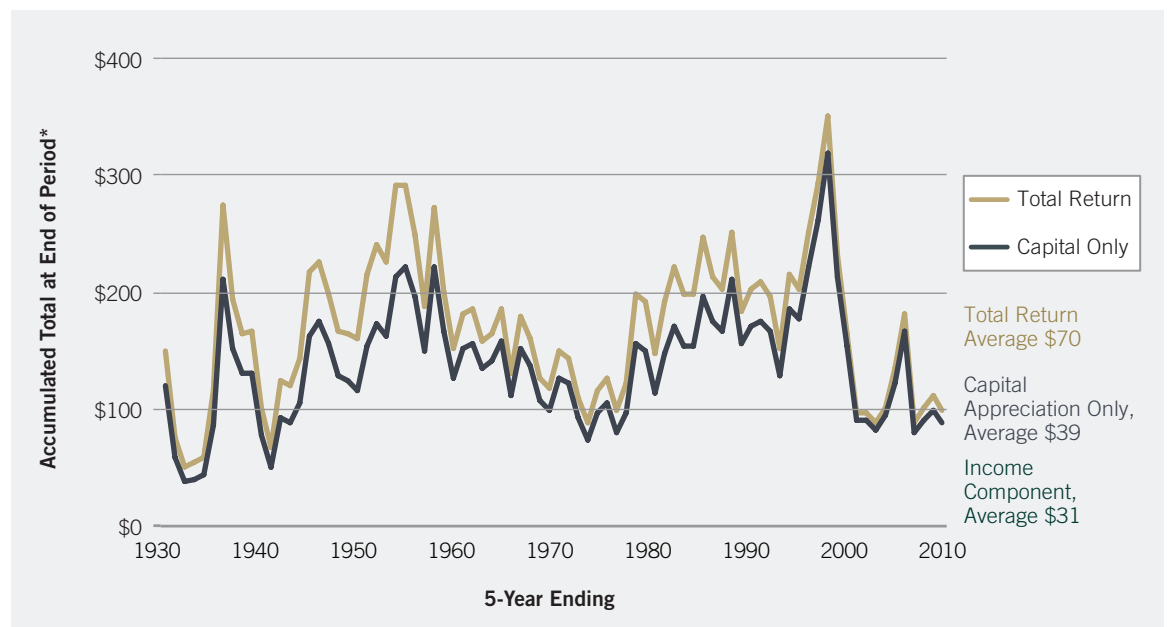
(a) U.S. Equities

The relevance of U.S. equity dividend yield has been challenged in recent years as yields had declined relative to historical norms.

The relevance of U.S. equity dividend yield has been challenged in recent years as yields had declined relative to historical norms. While dividend yields have increased over the past decade, the current S&P 500 dividend yield still sits at a modest 2% (as of July 31, 2012), low by historic and global standards. Our focus in this analysis is on the income component of returns, not just the level of dividend yield in isolation. Five-year windows of time are considered long term by some commentators, but in this research they are the shortest period we consider. For all 5-year rolling windows over the 1926–2011 period, income represented on average 44% of total returns. (In all the measurements in this research, we calculate this figure by subtracting the capital-only return from total return over the period.)

Given the weak capital-only performance of equities since 2000, it is not surprising to find that the equivalent number for the average of the most recent ten 5-year rolling windows is that income represented 92% of the (low) total returns over that period.

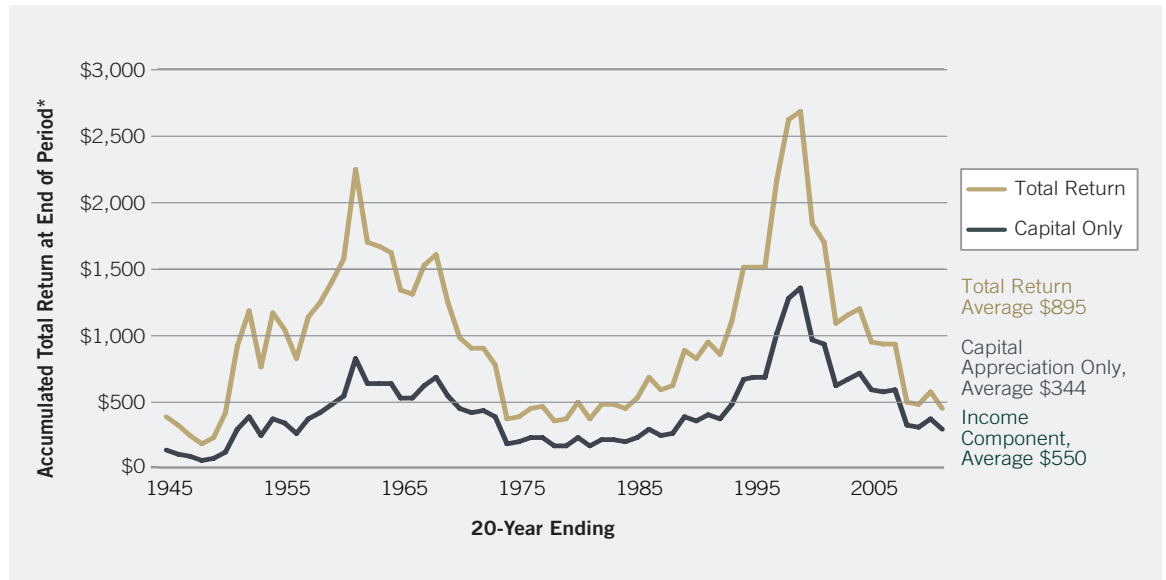
Exhibit 7: Total Returns and Capital Appreciation for U.S. Equity



Source: 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. *Each rolling period begins with an initial investment of \$100.

When we extend the rolling windows from five to 20 years, we get a better indication of the true long-term impact of income. We believe a 20-year timeframe has relevance both for institutional liabilities and for individuals investing for retirement and post-retirement. For these 20-year rolling windows, the income component rises to 61%. We find that the compounding effect steadily increases the importance of the income component as the time horizon is extended. For example, while not shown in these charts, the income component for 10-year rolling windows is 50%, and so for any time horizon past 10 years we find that the majority of returns have come from income.

Exhibit 8: Total Returns and Capital Appreciation for U.S. Equity

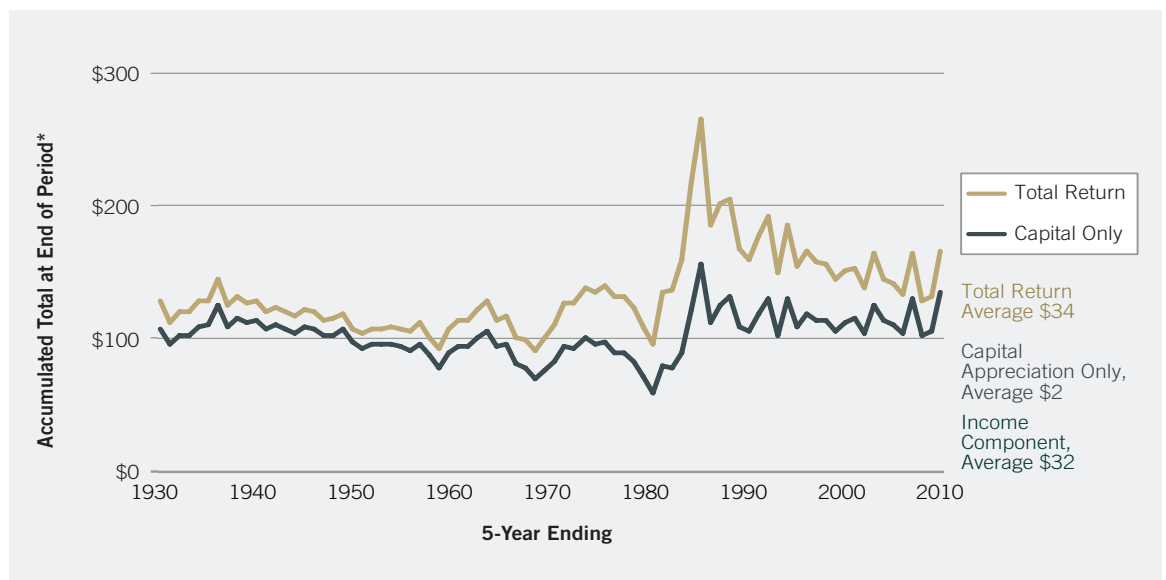


Source: Brandes Institute, based on data from Ibbotson Associates, Global Financial Data, Inc. and FactSet, as of December 31, 2011. Past performance is not a guarantee of future results. *Each rolling period begins with an initial investment of \$100.

(b) U.S. Fixed Income

The fixed income series used in this study is derived from the return on 10-year U.S. government bonds. As such, capital changes are primarily dependent on changes in the maturity yield. In the absence of a long-term secular directional trend in yields, the nature of these capital changes must be cyclical. As a result, over any period longer than a market cycle, the impact of income should be dominant over capital. The charts below illustrate this. For 5-year rolling periods, dividends represented 94% of total returns. This percentage increased to 99% when the rolling window horizon was increased to 20 years.

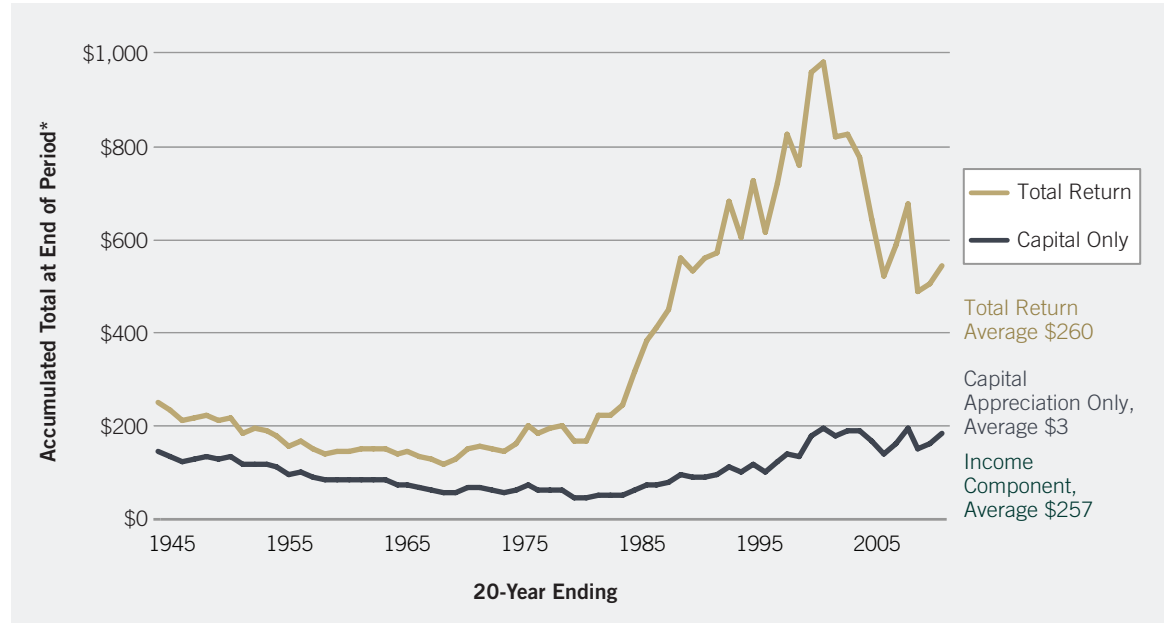
Exhibit 9: Total Returns and Capital Appreciation for U.S. Fixed Income



Source: 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. *Each rolling period begins with an initial investment of \$100.

One implication of the income dominance even over the relatively short 5-year rolling windows is that the value added from tactical market timing in this asset class may be quite small in comparison to the returns generated just by reinvesting income.

Exhibit 10: Total Returns and Capital Appreciation for U.S. Fixed Income



Source: 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. *Each rolling period begins with an initial investment of \$100.

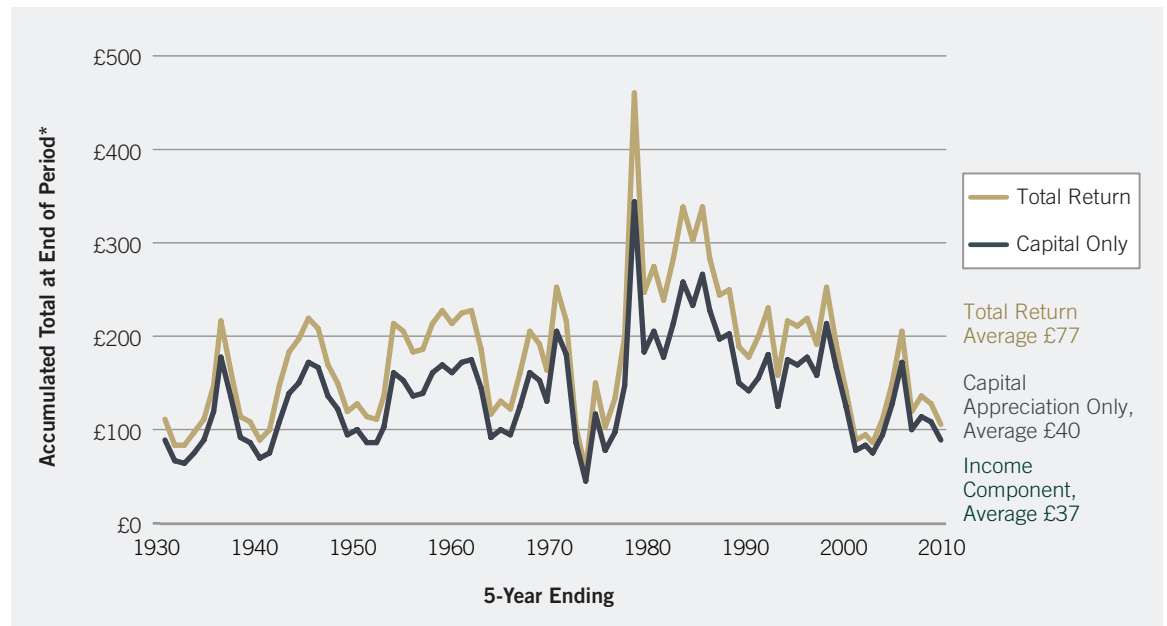
2. U.K. Asset Classes

(a) U.K. Equities

Dividend yields in the United Kingdom typically have exceeded those in the United States, and the proportion of dividend-paying stocks in the major indices also has been higher. Comparing large-cap indices in the two countries at the end of 2011, 94.1% of the 142 stocks in the FTSE All-World United Kingdom Index paid dividends vs. 78.4% of the stocks in the S&P 500 Index. This difference may contribute to the slightly higher proportion of income dominance in U.K. equities when compared to the United States. In the United Kingdom between 1926 and 2011, income averaged 48% of total returns across 5-year rolling periods.

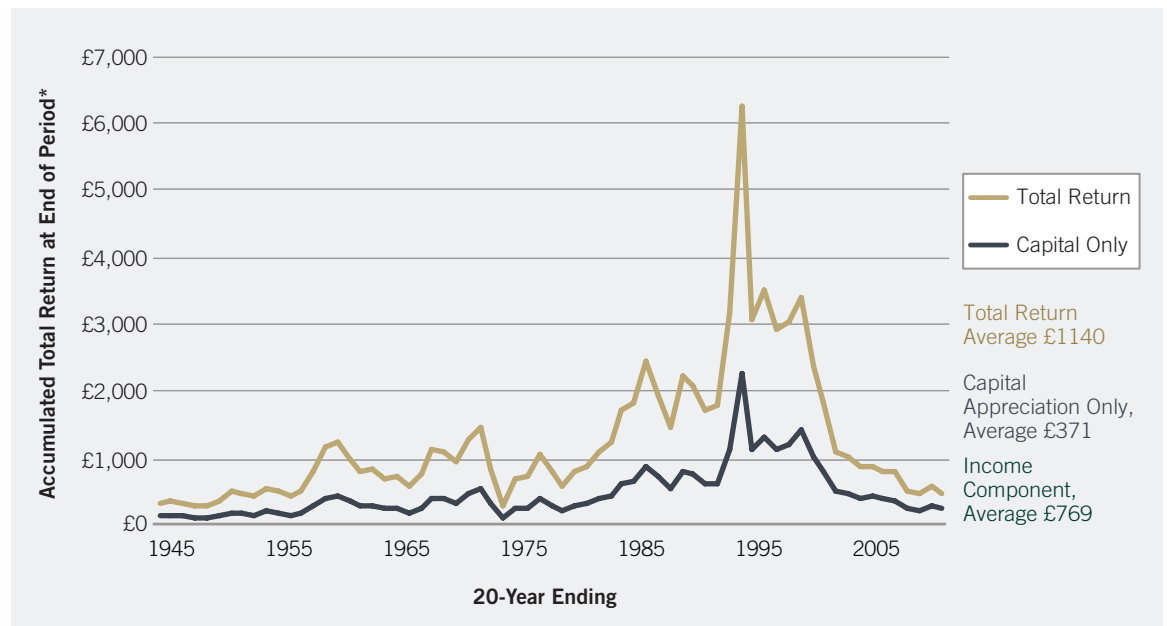
For 5-year rolling periods, dividends represented 48% of total returns for equities (for U.S. equities, dividends represented 44%). This percentage increased to 67% for U.K. equities (compared to 61% for the United States) when the rolling window horizon was increased to 20 years.

Exhibit 11: Total Returns and Capital Appreciation for U.K. Equity



Source: 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. *Each rolling period begins with an initial investment of £100.

Exhibit 12: Total Returns and Capital Appreciation for U.K. Equity

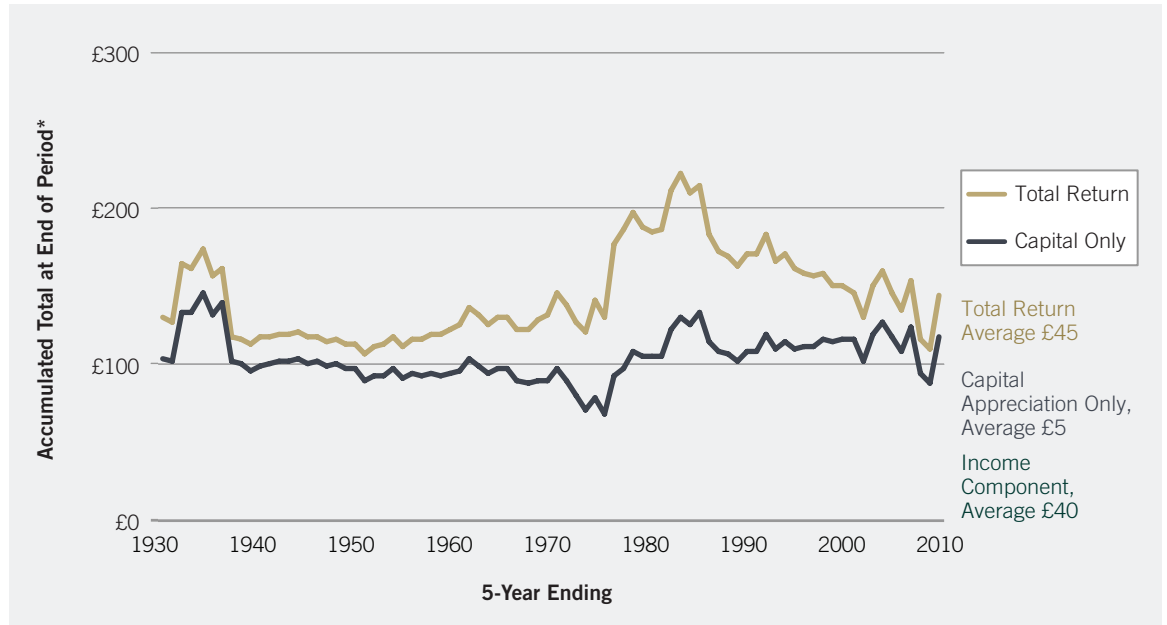


Source: Brandes Institute, based on data from Ibbotson Associates, Global Financial Data, Inc. and FactSet, as of December 31, 2011. Past performance is not a guarantee of future results. *Each rolling period begins with an initial investment of £100.

(b) U.K. Fixed Income

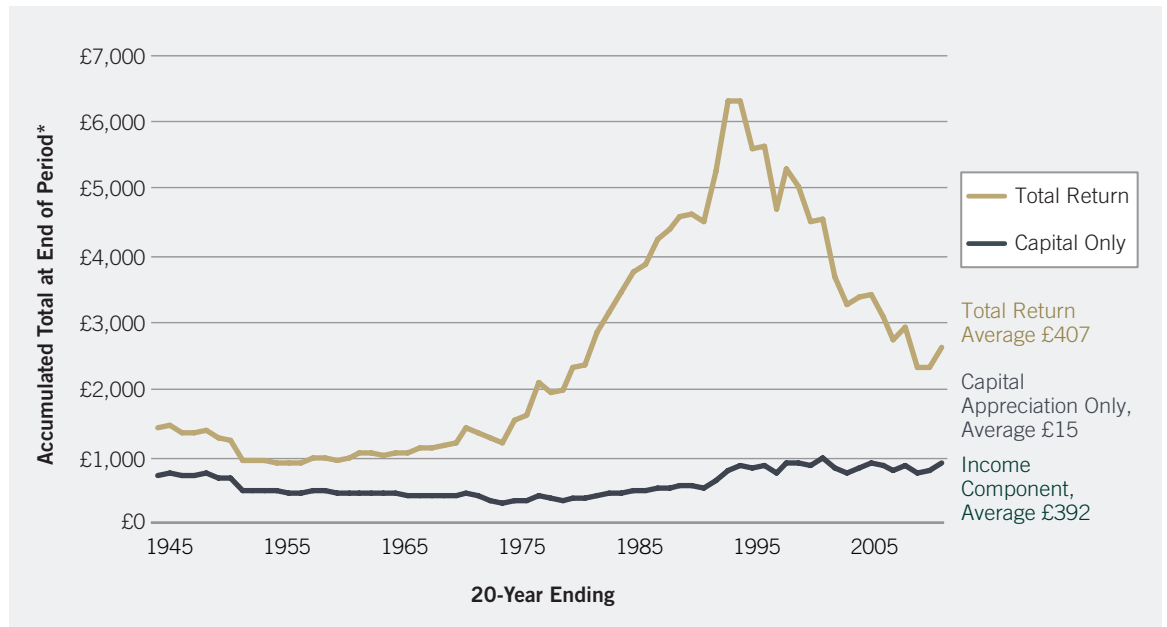
While the overall pattern of income dominance for fixed income returns is similar in the United Kingdom and the United States at the margin, the average U.K. capital contribution is somewhat higher. The differences are modest however, and do not impact the overall conclusion. In the United Kingdom between 1926 and 2011, income averaged 89% of total returns across 5-year rolling periods. This percentage increased to 96% when the rolling window horizon was increased to 20 years.

Exhibit 13: Total Returns and Capital Appreciation for U.K. Fixed Income



Source: 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. *Each rolling period begins with an initial investment of £100.

Exhibit 14: Total Returns and Capital Appreciation for U.K. Fixed Income



Source: 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. *Each rolling period begins with an initial investment of £100.

We note that this is not an apples-to-apples comparison, as the U.K. data is in pounds sterling, and a genuine comparison would have to take into account the local currency long-term returns (which were higher in the United Kingdom) and the long-term depreciation of the pound against the dollar. The behavior of these two factors (higher U.K. returns and currency depreciation) is closely linked.

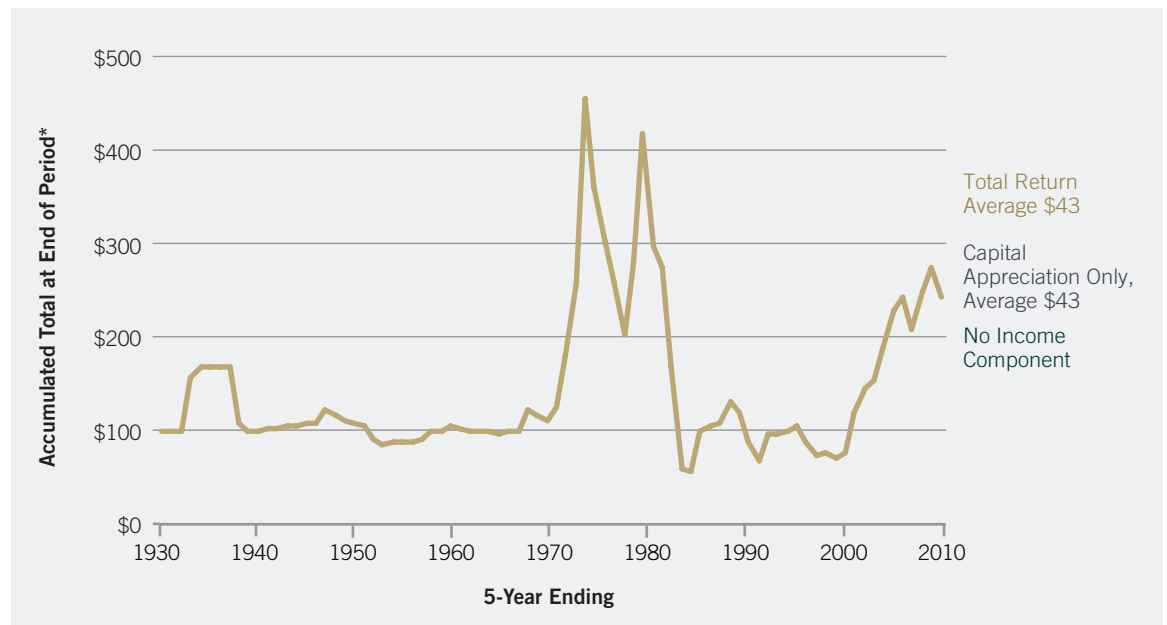
3. Non-Income Producing Asset: Gold

Gold bullion is considered by some investors to be a long-term inflation-hedge, but buying bullion provides no income so the success or otherwise of such a purchase depends entirely on the price movement. The long-term history of the gold price tends to be extended periods of calm interspersed with high volatility. During periods of high volatility, investors may see large profits or losses.

The recent surge in the gold price is the second in modern financial history. During the decade leading up to 1980, the price of gold rose by a factor of 15. In the decade ending 2011, its price grew by a mere 5½ times. This volatility is reflected in the rolling 5- and 20-year price charts, with the most recent move showing as a less pronounced spike compared to the one in the 1970s.

With no income, capital appreciation equaled total returns for gold across 5- and 20-year rolling periods between 1926 and 2011.

Exhibit 15: Total Returns for Gold

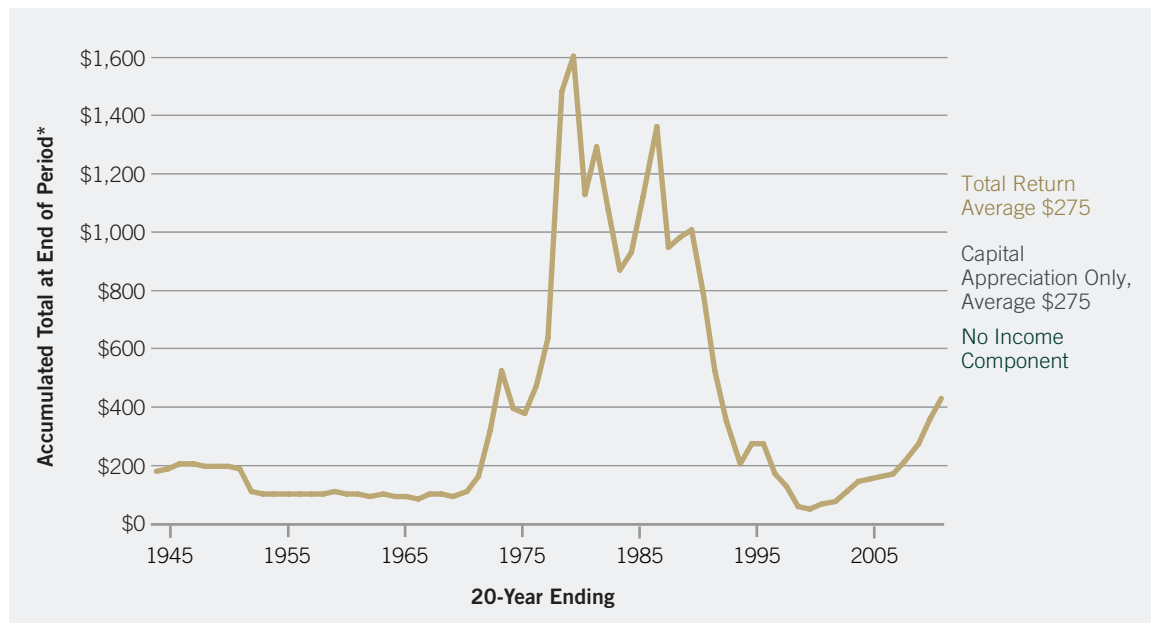


Source: Brandes Institute, based on data from Ibbotson Associates, Global Financial Data, Inc. and FactSet, as of December 31, 2011. Past performance is not a guarantee of future results. *Each rolling period begins with an initial investment of \$100.

Clearly such price behavior provides great profit or loss opportunities for those attempting to time the market. However, we're analyzing the impact for long-term investors, not shorter-term market-timers.

For true long-horizon investors, we also can provide data on request for the London spot price of gold dating back to 1257. That was when King Henry III introduced the first high denomination gold coin in England. However, its bullion content was higher than its 20-pence face value, so savvy individuals got busy melting the coins back into bullion. Disintermediation is not a modern phenomenon!

Exhibit 16: Total Returns for Gold



Source: 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. *Each rolling period begins with an initial investment of \$100.

Our data allows us to contrast long-term results for three very distinct asset classes when it comes to income component.

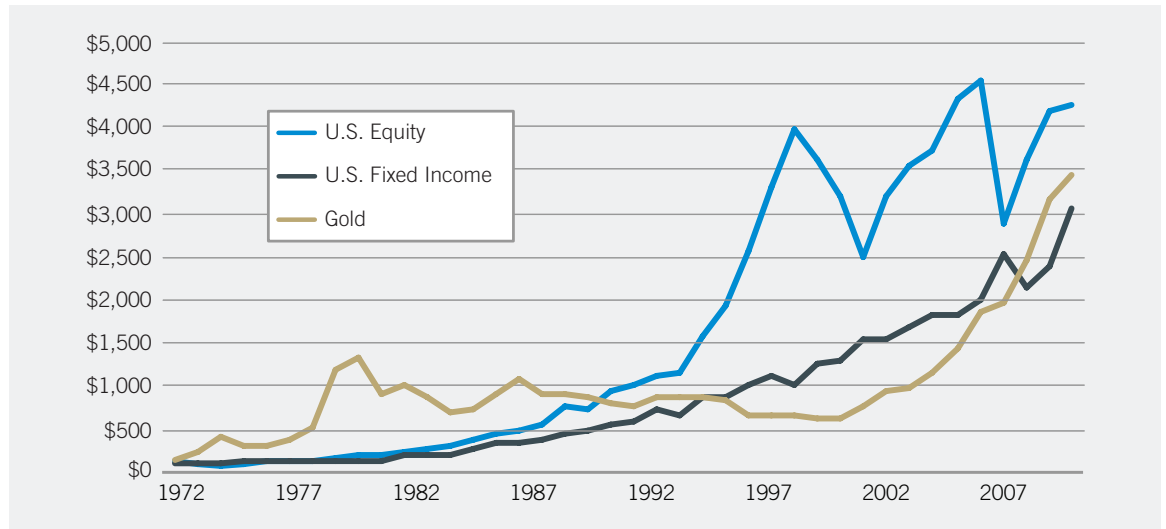
1. No income, all capital: gold (100% of long-term return is capital)
2. Primarily income: bonds (over 95% of total return comes from income for rolling periods of 10 years or more)
3. Mixed: equity (both income and capital contribute materially to long-term returns)

Over the full 86-year period studied, rolling year averages show that the pure capital asset (gold) and the (almost) pure income asset (bonds) have had long-term returns that are fairly similar, even though their patterns of shorter-term performance are materially different. But equities have outpaced both.

However for the first half of the period studied, the gold price was effectively fixed and gold was not an available asset class for investors. So it's useful to look at how gold has performed relative to the income-producing asset classes over the past 40 years.

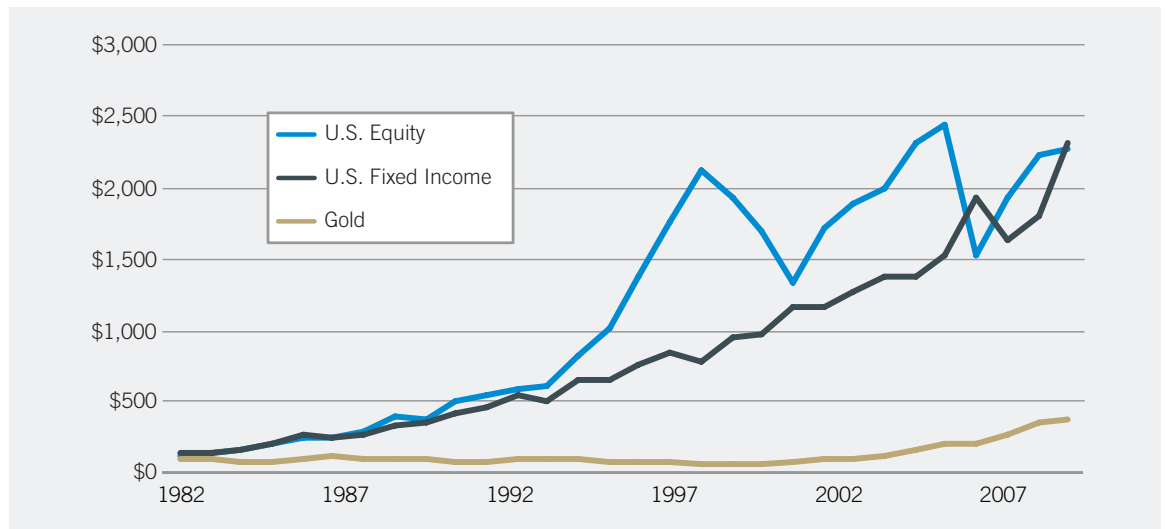
Exhibit 1 showed the total return for each of the three asset classes over the full period studied. To illustrate the importance of the starting date, we have used two different inception dates in the next two exhibits. Exhibit 17 covers 40 years starting in 1971 so that it captures the spike in gold prices during the 1970s. Exhibit 18 covers the 30 years since 1981, including the bond bull market during the entirety of that period, as well as the equity bull market that started in 1982 and lasted until the bubble at the end of the century.

Exhibit 17: Total Return for U.S. Equities, Fixed Income and Gold since 1971*



Source: 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. *Assumes an initial investment of \$100.

Exhibit 18: Total Return for U.S. Equities, Fixed Income and Gold since 1981*



Source: 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. *Each rolling period begins with an initial investment of \$100.

Over the full era of free market pricing for gold (Exhibit 17), the precious metal has outperformed bonds, but not equities. But the dramatic impact of changing the start date by a decade is illustrated in Exhibit 18, where gold drops to a distant third place despite the rally of recent years. This pair of charts also demonstrates why we prefer to use averages of rolling periods rather than point-to-point charts in our research. Given the results from our 86-year study of rolling periods of varying time horizons, Exhibit 18 reinforces the impact of the unprecedented bull market in bonds, with total returns from fixed income leading equities over that 30-year period.

Exhibit 19 illustrates how frequently each asset class (equities, fixed income or gold) delivered the best total returns (relative to the others) during each of the 5- and 20-year rolling periods in our study. While fixed income and gold had periods of superior returns, equities were the most consistent outperformers.

Exhibit 19: Number of Rolling Periods When U.S. Equities, U.S. Fixed Income or Gold Was the Best-Performing Asset Class, 1926 to 2011

	U.S. Equities	U.S. Fixed Income	Gold
82 Rolling 5-Year Periods	52	8	22
67 Rolling 20-Year Periods	48	4	15

Source: 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.

APPENDIX/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

U.K. Equity

The Banker's Magazine capitalization-weighted index of 287 stocks, 1926-1933

The Actuaries General Index, 1933-1962

The Financial Times-Actuaries All-Share Index, 1962-2003 (The All-Share Index is a capitalization-weighted price index and covers about 98-99% of the capital value of all U.K. companies), through Global Financial Data, Inc.

The FTSE All-Share Index (2003-2011), through FactSet.

U.K. Fixed Income

Yield: U.K. 2 1/2% Consol Yield, 1926-2011, through Global Financial Data, Inc. and the UK Debt Management Office (<http://www.dmo.gov.uk/>)

Total Return: United Kingdom 10-yr Govt. Bond Total Return Index, through Global Financial Data, Inc. and FactSet

Gold

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

Yield Gaps

All non-US bond yields are BofA Merrill Lynch Governments 7-10Y indices, through FactSet.

All non-US dividend yields are FTSE country specific indices, through FactSet.

DISCLOSURES

An alternative method for calculating the income component of total returns is to first determine the total annualized return for the index. Next, take the average of the series of annual dividend yield numbers over the full period; this is the income return. Then subtract the income return from the total return to get the capital gain.

In using the methodology we described in footnote 2 on page 2, we recognize the income component in our approach will be higher than the alternative method described above because of the cumulative impact of reinvesting dividends, which are counted as part of the income return. We believe our approach is the appropriate method for this research.

FTSE All-World United Kingdom: The FTSE All-World United Kingdom Index consists of the U.K.-based members of the FTSE All-World Index. The FTSE All-World United Kingdom Index includes dividends and distributions, but does not reflect fees, brokerage commissions, or other expenses of investing.

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. The information provided in this material should not be considered a recommendation to purchase or sell any particular security. It should not be assumed that any security transactions, holdings or sectors discussed were or will be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance discussed herein. Strategies discussed are subject to change at any time by the investment manager in its discretion due to market conditions or opportunities. Please note that all indices are unmanaged and are not available for direct investment.

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