

What will our children and grandchildren think when they look back on the stock market record for the first decade of the 21st century? I believe it probable that they will come to regard many aspects of this past decade as extraordinary. Space constraints limit us to discussing only two notable features in this piece:

1. Outstanding returns on South African investments

South Africa was the place to be (along with many other commodity-producing countries and emerging markets):

Decade returns (31 December 1999 - 31 December 2009)		
	Value of R1 000 invested on 31/12/1999	% Rand return per year
Allan Gray Equity Fund	R7 376	22.1%
FTSE/JSE All Share Index	R4 342	15.8%
MSCI Emerging Market Index	R3 139	12.1%
SA Bank Deposits	R2 515	9.7%
US Bank Deposits	R1 652	5.1%
FTSE World Index	R1 346	3.0%
S&P 500	R1 091	0.9%

2. Persistent optimism

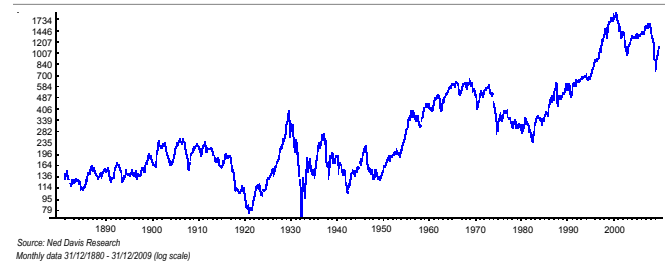
The inflation-adjusted S&P 500 Index was in secular decline for the decade. At the turn of the century, one S&P 500 unit could buy you about five ounces of gold. At the close of the decade, the same one S&P 500 unit traded at parity with an ounce of gold. Surprisingly, US stock market investors resolutely clung to their new millennium optimism (bar a 'wobbly' in 2008), despite the substantial loss in the real purchasing power of their capital. The S&P 500 even made a new nominal high in October 2007.

One indicator of this persistent optimism is shown in

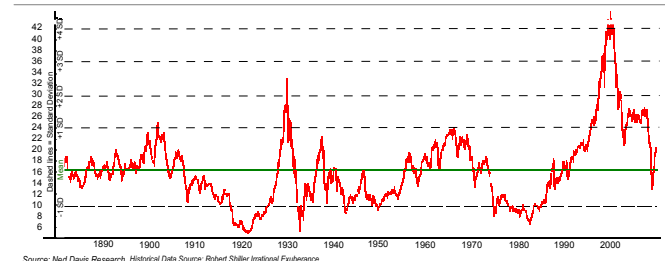
Graph 2 (from Ned Davis Research). Although the S&P 500's current price/earnings (P/E) multiple of about 20x on the trailing 10-year's average inflation-adjusted earnings is now lower than it was for most of the past decade, it remains high in a longer-term context.

The 'noughties' does not yet seem to have stuck as a name for this past decade. On scrutinising the graphs, will future generations prefer to label it the 'bubblyies'?

GRAPH 1 | Standard and Poor's 500 Index (inflation-adjusted)



GRAPH 2 | S&P 500 Index/10-year average earning per share (inflation-adjusted)



Investment implications

Investors should recognise that in previous periods of extreme pessimism stock market valuations have been much lower than current levels (and sometimes for many years). Investors should be wary of the risk that the past decade's optimism gives way to a more pessimistic mood. At Allan Gray, we continue to focus on opportunities for capital preservation within our mandate and regulatory constraints.

We wish all our clients a fruitful and prosperous new decade.

Ian Liddle, chief investment officer, Allan Gray Limited

Allan Gray Limited is an authorised financial services provider. Collective Investment Schemes in Securities (unit trusts) are generally medium- to long-term investments. The value of units may go down as well as up and past performance is not necessarily a guide to the future. Unit trust prices are calculated on a net asset value basis, which is the total market value of all assets in the portfolio including any income accruals and less any permissible deductions from the portfolio divided by the number of units in issue. The Equity Fund may be closed to new investments at any time in order to be managed in accordance with its mandate. The manager is a member of the Association for Savings & Investment SA (ASISA). The FTSE/JSE Africa Index Series is calculated by FTSE International Limited ('FTSE') in conjunction with the JSE Limited ('JSE') in accordance with standard criteria. The FTSE/JSE Africa Index Series is the proprietary information of FTSE and the JSE. All copyright subsisting in the FTSE/JSE Africa Index Series index values and constituent lists vests in FTSE and the JSE jointly. All their rights are reserved.