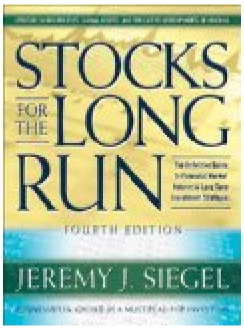
STOCKS FOR THE LONG RUN



The Definitive Guide to Financial Market Returns & Long Term Investment Strategies

By Jeremy J Siegel

Note: I reviewed the first edition. This illustration is of the fourth edition. Each edition gets better.

I have read hundreds of books about investing and trading over the years. Every now and then I come across one that stands out as being above the average. Such a book is Jeremy Siegel's excellent examination of stock market returns.

Stocks for the Long Run stands out for several reasons. It covers its subject matter in depth, yet is written in easily understood language. In places it excels in making difficult subject matter accessible to even inexperienced readers, while at the same time giving experienced readers new or clearer insights into familiar territory.

Unlike many books written by academics, it is not only easy to read, but is written with some passion for the subject. The enthusiasm of Siegel for the unravelling of the mystery of how to best profit from investing in stocks makes a dry subject fascinating. It even builds a tension as he stacks up the evidence and we become impatient for him to bring it all to a conclusion.

Above all, what stands out in this book is the scholarship. Unlike many of the popular books on investing, he rarely makes any statement without having researched the evidence. However, in presenting the evidence, he brings it to life with simple, clear explanations of what is sometimes quite arcane academic research. He also renders much of the evidence into charts and graphs, so that the ideas can also be grasped visually.

Jeremy Siegel is professor of finance at the Wharton School of the University of Pennsylvania. In 1989, the New York Stock Exchange commissioned Siegel and a colleague to write a history of the exchange. As part of the research for that book, he collected a mass of material on two centuries of stock market returns. Not only that, but the research pointed to some very surprising conclusions. It was sufficient indeed, for Siegel to write a separate book. The book was to not only detail the returns from investing in stocks, but investigate and explain what really influences stock prices.

Stocks for the Long Run more than fulfils this objective. The book is arranged in five sections. The first outlines the historical returns on stocks and bonds. It explores one of the great enduring controversies in investing, which unfolds as a drama in which first one theory upsets past orthodoxy, only to come into disrepute, before emerging again as a demonstrable truth about stocks.

The second part delves into returns in detail: how returns are calculated, what determines stock prices, large versus small stocks, value versus growth investing, taxes and international investing.

The third part explains the economics behind investing, the roles of the monetary system, central banks, inflation and the business cycle. I have never read a clearer explanation of these difficult topics than Siegel's brilliant and lucid discussion.

The fourth part looks at the short term, presents simple technical trading rules and surprising calendar patterns. This is not the strongest part of the book, but it will awaken an awareness of some important aspects of the investing riddle.

The final part of the book brings it all together into how to build wealth through investing in the stock market. We find why fund managers underperform the market. All this leads to some really simple rules for building a great investment portfolio.

Siegel's conclusion from his tour of the evidence about stock market returns will surprise many readers. Indeed, I suspect that many readers will find his conclusions unsettling, because he will be telling them that what they are doing now is the wrong way to achieve superior returns.

As the title suggests, he finds that long term investing is the way to go. However, he admits that "to be a successful long-term investor is easy in principle, but difficult in practice". Does this suggest that it is not worth the effort? To the contrary, he points out that "for most of us, trying to beat the market leads to disastrous results". Many readers will not want to admit this, even to themselves.

So, what is the value of this book? I think it lies in two places. Firstly, it will explain what the investing problem is and how it can be solved if we are strong willed enough to take the long-term approach. Secondly, it provides an independent yardstick against which to measure our own results and the results of the fund managers to whom we may give our money.

It is only when we understand the problem that can we begin to find the faith in the solution. Siegel's explanation of how the stock market really works and what actually drives investment returns will open your eyes. You will never read an advertisement for a fund or a get-rich-quick trading system in the same way again.

There are many myths about investing and trading. In reading this book many of them will be exploded before your eyes. In particular the paradox that taking more risk is less risky - that so called "risk-free" bonds are far more dangerous to your long-term financial health than owning stocks.

However, what you need to understand is how many stocks you should hold and what type of stocks. This is an important part of the solution to the riddle. I doubt that, having read this book, many readers will ever look at their portfolio the same way again. They will see that Siegel is right when he concludes that "we take far too many risks, our transaction costs are high and we often find ourselves giving in to the emotions of the time".

If you are unhappy about the returns you are getting now from stocks, then this book is a "must read". If you are just starting out and wondering which of all the investment paths to take, this book could be the best investment you ever make.

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Stock Fluctuations in the Short Run: Stock Index Futures, Options and Spiders, Market Volatility and the Stock Crash of October 1987, Technical Analysis and Investing with the Trend (here Siegel claims that the use of a 200-day moving average to analyze investments does not improve returns nor reduce risk for the Dow Jones Industrial Average, but it seems to benefit the NASDAQ. index), Calendar Anomalies (Siegel accepts seasonality in the stock market). Building Wealth Through Stocks: Funds, Managers, and 'Beating the Market', Structuring a Portfolio for Long-Term Growth.Â Siegel, Jeremy J. (June 21, 2002). Stocks for the Long Run : The Definitive Guide to Financial Market Returns and Long-Term Investment Strategies (3rd ed.). New York: McGraw-Hill. p. 388.