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We believe investors need to plan for 30 years of retirement. A review of past stock market returns and a look at future potential returns may provide insights that will help with your planning, both financially and psychologically.

We will review U.S. large cap stocks as measured by the S&P 500. Though this is only one asset class, some of the conclusions can be broadly applied.

There are three main takeaways from this review. First, in the future, you will need to rely more on savings than returns to maintain or improve your lifestyle. Second, you will need to be careful not to exhaust your savings. Third, you will need to pay closer attention to taxes.

Despite weak returns over the past 10 years, the past 30 years have been good for stocks. For the 30 year period ending December 31, 2011, the average annual return for the S&P 500 can be broken out as follows:

Total Return	10.9%
Earnings Growth	6.3%
Average Yield	2.9%
Valuation Increase (P/E)	1.7%
Inflation (CPI)	3.1%
Real Return	7.8%

The biggest "surprise" in the above table may be the Total Return figure for the S&P 500 index: **10.9% a year for 30 years**. Investors know how poor the past ten years have been. However, they need to remember that over a 30 year period a mediocre decade can be overcome.

The Valuation Increase (P/E) refers to the increase in the price earnings ratio from the end of 1981 through 2011. Based on trailing earnings, the P/E ratio increased from 8.1 times on 12/31/81 to 13.2 times on 12/31/11. The 12/31/81 P/E was low because the U.S. was experiencing very high inflation, over 10% for 1979, 1980 and 1981. High inflation raised bond yields and depressed P/E ratios.

Real returns (Total Return minus Inflation) of 7.8% were excellent over the past 30 years. This was well above the 20th century average of close to 6% a year.

What might the next 30 years look like? The returns will not be as forecast, but the comparison with the past is helpful for planning and managing expectations. Using 12/31/11 as the starting point, the average annual returns for the next 30 years **might** look as follows.

Total Return	7.5%
Earnings Growth	5.0%
Average Yield	2.1%
Valuation Increase (P/E)	0.4%
Inflation (CPI)	2.5%
Real Return	5.0%

The total return figure, both nominal and real, are **materially lower** than that past 30 years. Three reasons should be highlighted. First, the U.S. economy is 5 times larger than it was 30 years ago. The increased size makes it hard to maintain past growth. Second, current governmental and individual debt levels reduce growth. The effect could be as much as a 1% per year reduction in GDP growth. Third, the starting valuation level is higher than it was back in 1981.

The difference between 7.8% a year and 5.0% a year is significant over a 30 year period. One dollar compounding at 7.8% for 30 years grows to $9.5 dollars. In comparison, one dollar compounding at 5.0% for 30 years grows to $4.3 dollars. This means individuals need to be careful and realistic about how much they withdraw from their portfolio. Exhausting your savings is not a good strategy.

Tax planning is always important. However, given the expectations for lower returns, such planning takes on an even greater importance.

We are not pessimistic. We simply want investors to have realistic expectations and to make solid financial decisions. The next 30 years will require you to rely more on savings and less on returns, to be careful about your withdrawal rate and to pay closer attention to taxes.

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