

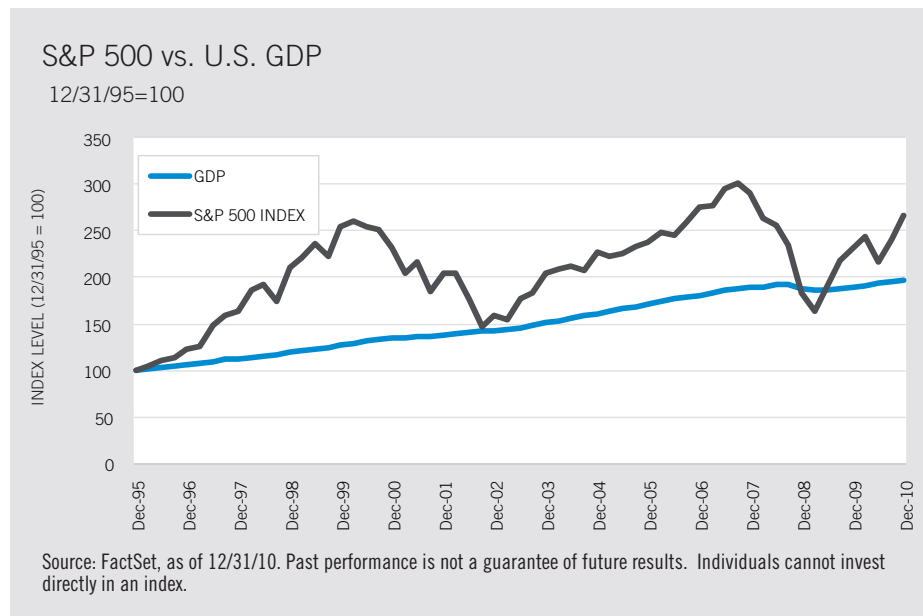
Brandes

observes:

Gross Domestic Product: A Poor Predictor of Stock Market Returns

Do changes in gross domestic product (GDP) provide a useful signal regarding future returns for stocks? A review of the last 15 years of market data suggests the answer is no.

The chart below tracks U.S. GDP and the S&P 500 Index from 1995 through 2010. The annual changes in GDP during this period ranged from -1% to 6%. In contrast, the S&P 500's annual returns were much more volatile, ranging from -37% to 33%.





The table below sorts the data for the years 1996 through 2010 by GDP growth, ranging from 2008's loss of 0.7% to 1999's gain of 6.4%. The year of the lowest GDP growth, 2008, also featured the lowest return for the S&P 500. But in the year of the second-lowest GDP growth, 2009, the S&P 500 posted one of its *highest* returns, a flip-flop that highlights the inconsistent relationship between the two variables.

	GDP	S&P 500 Index
2008	-0.7%	-37%
2009	0.6%	26%
2002	0.6%	-3%
2001	2.4%	-12%
2010	4.2%	15%
2007	5.0%	5%
2006	5.4%	16%
2000	5.4%	-9%
1997	6.0%	33%
2003	6.0%	29%
1998	6.1%	29%
2005	6.3%	5%
1996	6.4%	23%
2004	6.4%	11%
1999	6.4%	21%

Source: FactSet, as of 12/31/10. Past performance is not a guarantee of future results.

A look at the same data in annual order suggests that years when GDP growth slowed versus the previous year *tended* to also feature lower returns for the S&P 500 — though this tendency was not ironclad. For example, in 2004 and 2005, GDP remained very strong, but the S&P 500's gains were lower than in other strong GDP years. More recently, GDP growth accelerated sharply from 2009 to 2010, but the S&P 500's gain in 2010 was significantly higher than in the previous year.

	GDP	S&P 500 Index
1996	6.4%	23%
1997	6.0%	33%
1998	6.1%	29%
1999	6.4%	21%
2000	5.4%	-9%
2001	2.4%	-12%
2002	0.6%	-3%
2003	6.0%	29%
2004	6.4%	11%
2005	6.3%	5%
2006	5.4%	16%
2007	5.0%	5%
2008	-0.7%	-37%
2009	0.6%	26%
2010	4.2%	15%

Source: FactSet, as of 12/31/10. Past performance is not a guarantee of future results.

A longer-term, global look at the link between GDP and stock market returns was performed by Elroy Dimson, Paul Marsh, and Mike Staunton in the 2002 edition of *Triumph of the Optimists*. “We find no link between stock market performance and GDP growth,”¹ the researchers wrote. They estimated the correlation of GDP and stock gains for the 1950 to 2000 period to be just -0.03, quite close to zero, which would indicate a complete lack of correlation.

Conclusion

Investors should be aware that research indicates GDP has historically been a poor predictor of stock market returns. Market participants who wait for GDP levels to improve before investing may find themselves on the sidelines, missing out on attractive investment opportunities among equities.

“Investors should be aware that research indicates GDP has historically been a poor predictor of stock market returns.”

¹ Dimson, Marsh, and Staunton. (2002). *Triumph of the Optimists*. Princeton University Press. p. 156.

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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