

Stock markets do not create value

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As many readers will know, I am not the greatest fan of stock markets. I consider most activity on such markets to be exploitative because of the asymmetry of the information available to investors. Much of it, from the pay directors take to the actions of most market managers, I consider to be rent seeking. The idea that equities provide strong returns is pretty much an urban myth, in my opinion, based on selective reading of data in those periods between market crashes.

There is quite a lot of evidence to support my view in an article by long-term and highly opinionated equity investor Terry Smith in the [FT this morning](#). As he notes he did this based on '*a research paper by Hendrik Bessembinder published in the September edition of the Journal of Financial Economics posed the question "Do Stocks Outperform Treasury Bills?" with some rather worrying conclusions for most equity investors.*' I should make clear that the research is US based. I have no reason to think that performance in the UK is any different.

The main conclusions is that the majority of shares do not perform nearly as well as government bonds. It is an exceptional few that make it look as though shares outperform gilts.

Since 1977 the median new shares issued on the stock exchange has delivered a negative rate of return, even with dividends reinvested.

On average, a quoted security has a life expectancy of just 7.5 years over the 90 year period studied. No wonder short-termism is rife.

And as he notes:

Just five companies out of the universe of 25,967 in the study account for 10 per cent of the total wealth creation over the 90 years, and just over 4 per cent of the companies account for all of the wealth created.

So, what is to be learned?

First, the stock exchange is not a business funding mechanism: it is a business exit strategy for most companies.

Second, most people are fools to take part in this game.

Third, if you insist on taking part only invest in the best stocks.

Fourth, since you have no way of knowing which ones they are, invest in a market tracker.

Or fifth, buy gilts.

But whatever you don't believe the story that the market deliver higher rates of return than government bonds: 96% of it does not.