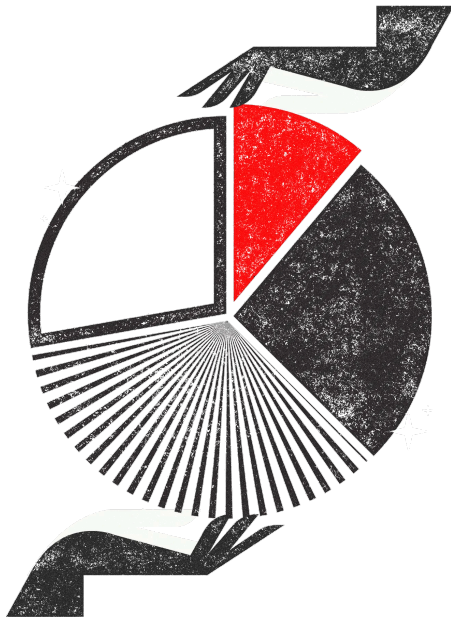


Inside the cult of equities

EQUITY OWNERSHIP IS MORE POPULAR TODAY THAN EVER. IN THE US, OVER 60% OF HOUSEHOLDS SAY THEY INVEST IN SHARES.¹ And equities account for a record proportion of household's financial assets (47%, up from 19% in 2009).² But what underpins equities' popularity? And how long can it continue, given current valuations?



IAN REES
Fund Manager

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FAVOURED ASSET CLASS. REWIND TO 1979, WHEN US INFLATION HIT 11.3% AND STOCK MARKETS MOVED SIDEWAYS FOR A DECADE – BUSINESSWEEK DECLARED ‘THE DEATH OF EQUITIES’. REWIND FURTHER.

After the Wall Street Crash of 1929, an entire generation swore off stocks, having watched their wealth evaporate. The Dow Jones Index didn't return to 1929 levels until 1954. Before the 1920s, equity investing was considered little better than gambling, while bonds and property were considered the prudent investment choices. So what are equities and why have they become the object of such devout worship?

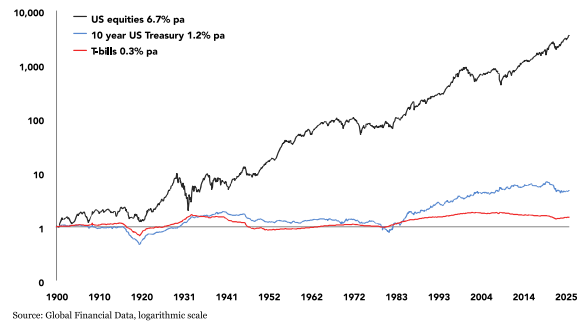
UNINITIATED

An equity gives you part ownership of a company – hence the alternative name ‘share’. That ownership entitles you to a claim on the future earnings of the company. But, as an owner, you are at the bottom of the company’s capital structure. In plain terms, if the company goes bankrupt, there is typically nothing left for common equity holders once the creditors (including bondholders) have been repaid. So equity ownership brings higher risks than bond ownership.

But riskier investments tend to produce higher returns over the long term, because investors have to be compensated for taking on that risk, rather than putting their cash in government bonds or the bank. And equities have certainly delivered.

Over more than a century, they have generated far higher returns than any other widely accessible asset class. There was no mystery to this. It was simple arithmetic: modest income, modest growth and a great deal of time for compounding to assert itself (of which more later).

In real terms, £1 invested in UK equities in 1900 is now worth £252, while \$1 invested in US equities is worth \$3,462 (Figure 1).³ These staggering returns came despite several challenging periods, such as the Great Depression, two world wars, the inflation troubles of the 1970s and the global financial crisis (GFC). Certainly, they tower over the returns from bonds and cash (here represented by Treasury bills) over the same period.



“Compounding is asymmetric: over time, the gains from the appreciating stock increasingly outweigh the shrinking losses from the declining stock.”

But, as we said, the reason for these huge returns was equities' higher risk. So what does risk mean?

At Ruffer, we aim to protect against the permanent loss of capital. Equities are one asset class within our portfolio, which we view in its entirety: is the portfolio as a whole producing consistent positive gains? We therefore consider what role equities can play within the broader portfolio.

For most investors, however, risk is measured as volatility: how much the share price fluctuates. As legendary investor Charlie Munger noted, you have to be prepared for substantial volatility: "If you can't handle a 50% drop, you deserve a mediocre result."

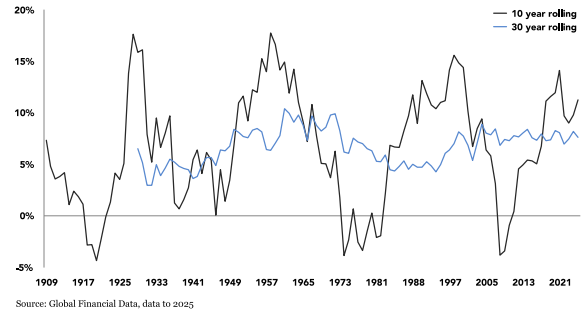
And equities are volatile. While the median monthly return for the S&P 500 since 1900 is 0.9%, the worst month saw a fall of 29% and the best a rise of 43%. Being out of the market during the bumper months makes a massive difference to the overall returns. For the same \$1 invested in 1900, if you

individual months – less than 1% of the period – your dollar value today would be 90% lower at \$331. That suggests you should buy and hold, to avoid missing the best months.

Conversely, by avoiding the worst individual 12 monthly returns, you would have achieved a return of \$49,284 over the same period. That illustrates the allure of trying to time the market – buying when the market's valuation is low and selling when it is high. In practice, however, predicting exactly when to be in or out of the market is impossible.

UNEVEN OUTCOMES

These long-term charts underscore equities' appeal. But they don't clearly show the experience of an individual investor during discrete periods: equity returns haven't spread their joy evenly over the past century. The great lottery of when you began investing would have had a lasting impact on your returns – and on your perception of equities.



Contrast the fortunes of someone approaching retirement in the early 1980s with someone approaching retirement today (Figure 2). The 1980s retiree had the misfortune of having invested over a period when equities delivered a negative real return over ten years and just 5% per annum over 30 years. In comparison,

someone approaching retirement today will have enjoyed annualised real returns of 11% over the past ten years and 8% over 30. The difference between 5% and 8% is not that great over one year. But, when compounded over 30 years, it will produce starkly different outcomes: gains of 332% and 906%, respectively.

OWN?

With the increasing popularity of passive funds, investors increasingly own all of the index. One justification for passive investing is the performance of the average active manager, who fails to clear their benchmark hurdle – even before fees. Another is the work of Hendrik Bessembinder, who looked at the performance of US stocks dating back to 1926. His analysis showed that 99% of the market's return was driven by less than 4% of stocks. Just the top 30 stocks contributed 82% of the overall return.

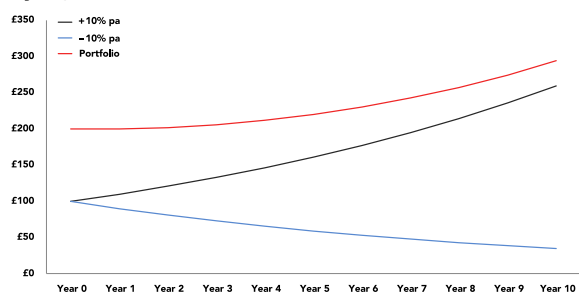
Bessembinder also found that more than half of the stocks in his study delivered negative returns over their lifetime – a healthy reminder that very few companies consistently deliver decade after decade. This concentration explains why broad index ownership has been so powerful: it guarantees

minority of extreme winners without requiring the investor to identify them in advance.

But how can a few winners outweigh the losers? The magic of compounding is biased towards winners over time. Imagine you own two stocks for ten years, each with the same starting value. The first one rises by 10% annually while the second falls by 10% (Figure 3). The result isn't that the two net themselves out.

Compounding is asymmetric: over time, the gains from the appreciating stock increasingly outweigh the shrinking losses from the declining stock. As a result, an overall portfolio can grow despite some underperformers: most stocks fail to deliver value, but the overall outcome is positive. Most investors will have at one stage in their career heard the adage run your winners. History suggests there may be value in that advice.

Figure 3 THE ASYMMETRY OF COMPOUNDING



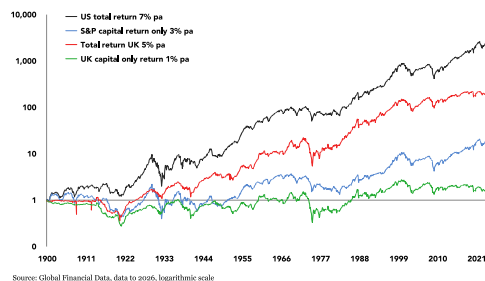
DECISIONS

Long-term equity value has been delivered from earnings: the profits businesses generate, reinvest and distribute provide the basis for shareholder returns. Earnings growth doesn't track GDP in the short term. But, over the long term, the capital return from equities (excluding dividends) has been in the low single digits – showing that profits are tied to economic growth. The distribution of earnings used to come from dividends but has shifted in recent decades towards the use of share buybacks, where companies use their cash to purchase their own shares, thus reducing the total shares available. This not only returns cash to investors (like dividends) but also boosts earnings per share and can signal confidence to the market. This practice has been particularly prevalent in the US.

In today's hyper-connected world, where **narratives drive markets more than normal** and investing is accessible to

collecting a 3% dividend yield may seem archaic, particularly to newer market participants. However, that does a great disservice to dividends' contribution to long-term equity returns. As Figure 4 illustrates, reinvesting dividends has a major impact on returns. The compounding effect of 3%-4% per annum, on top of earnings growth, is the difference between \$1 in 1900 being today worth \$26 or over \$3,000.⁴

Management decisions can also profoundly influence equity returns. Cash distributions – dividends and buybacks – deliver value directly to shareholders. But earnings and, ultimately, valuation are affected by companies' capital allocation and operational discipline. Capital allocation is deciding what to do with available funds – whether to invest it in equipment or R&D to promote long-term growth or to return it to shareholders. Operational discipline is focusing on more efficient business practices.

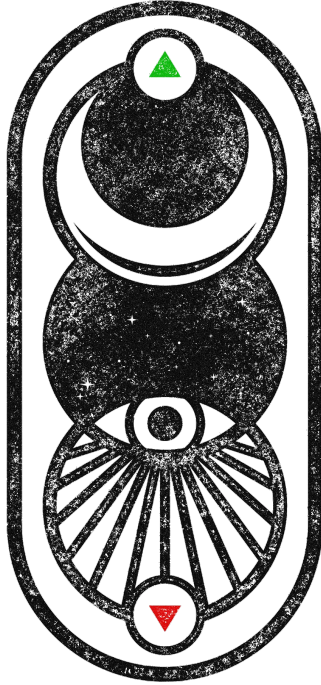


Source: Global Financial Data, data to 2020, logarithmic scale

Japan provides a recent example. The asset bubble collapse, which started in 1990, was followed by decades of depressed valuations. In recent years, however, investor sentiment has materially improved thanks to reforms emphasising capital efficiency, stronger

corporate governance and increased shareholder returns via dividends and buybacks. Despite modest earnings growth, disciplined management has led to higher valuations and stronger returns. Corporate decisions matter to equity outcomes.

“Pay too much for shares and you may be stuck with a lost decade for returns, or worse.”



GETTING WHAT YOU PAY FOR

But equities have an Achilles heel: valuation. Pay too much for shares and you may be stuck with a lost decade for returns, or worse. While there is no quantitative limit on valuation, it cannot rise ad infinitum. If earnings are the economic reality, valuation is the market's perception of that reality. Investors cannot dictate future corporate earnings, but they can control the price they are willing to pay for them. Valuation therefore becomes the most controllable determinant of future returns and the key safeguard against overpaying.

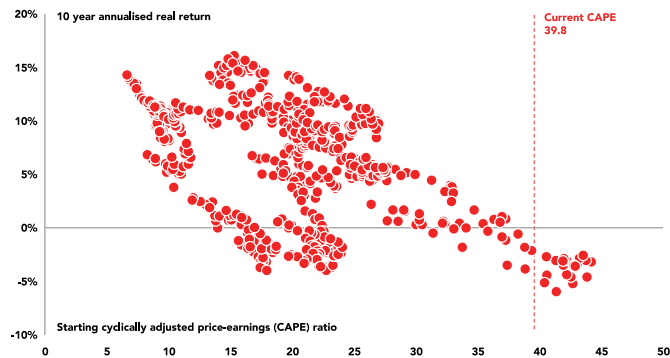
From the GFC low to the end of 2025, valuation alone, via a rising multiple paid for future earnings, contributed roughly 5% a year to total equity returns. The danger with today's US equity market valuation, which sits firmly at the more expensive end of the scale, is that it will drop back. We just don't know

when. And, if history teaches us anything, investors can overshoot at both ends of the confidence spectrum.

When an investor pays a high multiple for an equity, they are placing greater reliance on that business's earnings and income for future returns. As Figure 5 illustrates, when investors have bought the market at current valuations, they have experienced meagre returns over the next ten years.

However, many markets elsewhere do not look as over-valued – not least because the cult of equities is not as firmly entrenched around the world. Look at the UK. Today, £69.5 billion is sitting in Cash ISAs but just £31 billion in Stocks and Shares ISAs.⁵ If more Britons joined the faithful and invested in equities, it would not only help to support the economy but should also provide higher returns for investors in the long run.

Figure 5 REAL RETURNS FROM US EQUITIES VERSUS STARTING CAPE RATIO



Source: Shiller Data, Ruffer calculations. Each dot represents a 10 year rolling period from 31 December 1960 to 31 January 2026

REVELATION

In the end, the case for equities is no mystery; it is arithmetic applied over time in markets that survive long enough to allow compounding. Equity investing rewards patience but penalises overpaying. While the cult thrives today,

believers will no doubt see their faith tested again. When this happens, they should remember to consult the auguries of the long-term data. The cult of equities persists not because of blind faith, but because history has repeatedly rewarded those who respected these timeless principles. ●

- 1 Gallup, 2025
- 2 Federal Reserve
- 3 Global Financial Data

- 4 Global Financial Data
- 5 HM Revenue & Customs



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