Once you are convinced that stocks and bonds are the practical investment for most people, the question naturally arises, “which one is better?” Unfortunately, there is no easy answer. Stocks have had a historically much higher rate of return (10% compared to 5.6%), but bonds have less variability, or risk.[4] One of the fundamental insights of financial economics is that higher returns come with higher risk, and conversely, if you want lower risk you have to accept lower returns.

In Figure 1, below, we see the dramatic difference the higher rate of return on stocks makes compared to bonds. In this example, if you invested $100 in both an S&P500 stock fund and in a corporate Baa rated bond fund over the past 40 years, you would end up with substantially more wealth from stocks.[5] Notice, however, the severe downturns in the stock market in the early 2,000s and during the “Great Recession” of 2007-2009. From 2000 to 2003 the S&P500 declined a cumulative 40%, and in 2008 alone declined 35%! The stock market, as measured by the S&P500, has had 14 annual declines since the end of WW2, with 6 of those years declining by 10% or more.

Conversely, as you can see from Figure 1, the bond market had only minor declines from trend. In the early 2000s the bond market did not decline at all and in 2008 only fell 5%. Bonds are not perfectly safe

companies providing these services and most stock brokerage firms do as well. A quick internet search will provide a list.

For those who have access to a company 401K or other retirement plan the mutual fund companies will have already been chosen for you. All you need to do is make the allocation of your contributions to the plan among the various options. One of the biggest financial mistakes a person can make is not taking advantage of company sponsored retirement plans. The money invested is tax-deferred until retirement, and most companies will contribute a matching amount to your account (but nothing if you don't contribute). This matching contribution