EXHIBIT NO. ___(RAM-19)
DOCKET NO. UE-060266/UG-060267
2006 PSE GENERAL RATE CASE
WITNESS: ROGER A. MORIN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-060266** **Docket No. UG-060267**

FOURTH EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED REBUTTAL TESTIMONY OF
ROGER A. MORIN
ON BEHALF OF PUGET SOUND ENERGY, INC.

AUGUST 23, 2006

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

WUTC v. PUGET SOUND ENERGY INC.

DOCKET NOS. UE-040641 & UG-040640

DIRECT TESTIMONY OF STEPHEN G. HILL (SGH-1T)

ON BEHALF OF

PUBLIC COUNSEL

SEPTEMBER 23, 2004

According to Ibbotson Associates[22] the average market return over the past 77 years has ranged from 10.4% to 12.4%. Moreover there exists recent research on the subject of market risk premiums that indicate the Ibbotson Associates data may be somewhat overstated. For example, Siegel (Siegel, J., Stocks for the Long Run, 1994, Irwin, Chicago IL, p. 20) shows that over the very long-term history (reaching back into the 1800s), a more normal risk premium between stocks and bonds is 2% to 3%. Fama (Fama, E. and French, K., "The Equity Premium," *The Journal of Finance*, Vol. LVII, No, 2, April 2002, pp. 637-659) found a representative risk premium to range from 2.5% to 4.3%, again well below the Ibbotson estimates. Also, Dimson, et al, (Dimson, March and Staunton, Triumph of the Optimists, Princeton University Press, Princeton NJ, Oxford England, 2002) found that even the return data in the Siegel publication is questioned as being too high, due to "survivor bias." That phenomenon, according to Dimson, exaggerates historical stock returns by one to two percentage points.

In sum, Dr. Cicchetti has again based his return estimate for the risk premium portion of the CAPM on stock price growth rates—a very volatile series that can lead to extreme distortions of investor expectations especially when short-term time periods are studied. The result of that flaw is a market risk premium estimate (12.91%[23]) that is *double* the highest Ibboston long-term historical estimate of 6.60%[24], which, according to recent academic research, may also overstate the actual investor-expected return premium for investing in stocks rather than bonds. Simply substituting Ibbotson's long-term arithmetic market risk premium of 6.60% for Dr. Cicchetti's selected 12.91% in the

[22] Stocks, Bonds, Bills and Inflation: Valuation Edition, 2004 Yearbook, p. 28.
[23] Cicchetti Direct, p. 40: 17.8% market return less 4.89% risk-free rate = 12.91%.
[24] See Exhibit___(SGH-12) attached to this testimony. 6.60%= arithmetic return differential between stocks and long-term Treasury bonds over the past 77 years.