



Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive KEN FISHER argues that investors' doubts about the current state of the economy can offer rewarding buying opportunities

Investors' fears offer a good chance to buy

My call last month to return to bullishness was obviously premature. But I think I was merely early rather than basically wrong. Most investors have adopted a fearful tone based on the same old stuff. Earnings, valuations, terrorists, nuclear war, accounting scandals and a myriad of variations on these themes. They stretch for ghoulish visions and cling to craven mythology. There is little to fear. Why? Exactly because people are now so fearful. In my 30-year career and in all market history I've studied, when folks become materially fearful it always ends up being rewarding to own equities – if not immediately, then soon.

For example, folks fret the market's price to earnings ratio (P/E) is high and has got higher since the bear market started. But that is normal. Earnings fall faster than prices in most bear markets and they are affected normally at this time by a huge pick up in write-offs.

Despite long-held mythology, the market's P/E never tells you anything about where the market is going – looking months or years out. So is the market reasonably priced? Yes. How so?

Historically, US industry generates an average 5% after-tax profit margin – which rarely rises above 6% or below 4% (only in recessions). Also, over a decade revenue grows by at least 50%. The US market now sells at 1.3 times revenue, which at a future 5% margin is a 3.9% earnings yield. With future 50% growth, that evolves in 10 years to an approximate 5.7% earnings yield, rendering a decade average of 4.8% – slightly less than a 10-year US Treasury Bond. But the



tax treatment of the earnings yield is vastly superior to that of the bond yield – hence the market is reasonably priced.

So, the after-tax return on owning businesses should exceed that of bonds. Does that mean stocks will fare well or sadly? Again, the one has little to do with the other in history. Stock returns versus the so-called "equity risk premium" is almost random in history, bouncing all over the place. As I said last month, market prices aren't about valuations in periods of months or years, but about shifts in supply and demand for securities.

Won't there be more accounting scandals? Sure. Will that force the market down? No. Write-downs are normal late in a bear market, occurring in high volume and making profits seem less than they really are. They are reflections of the past, not the present or the future. They don't effect the look-ahead operating profit margin at all.

A smart new CEO in any company

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now while folks are bombarded by write-downs, blaming it on the past and paving the way for a better reported future. It is the first lesson in CEO school – write down first, build later. In various formats this has gone on late in most bear markets.

What about terrorists, nuclear war, dirty bombs and all the rest? The truth no one speaks is that despite terrorists getting one very lucky strike at the western world last 11 September, everything we've seen since demonstrates their fecklessness. The only things they are good at is hiding and small-scale suicide bombs. If this year's suicide bomb were to concentrate solely within the US in the future, Americans would be far better served to fear its regular drunk drivers who are both vastly more numerous and more deadly.

Don't believe me? Well, first, buy Rayonier stock (the American forest products company – to be found at www.Rayonier.com). Then fly to Seattle and drive the Olympic Peninsula. You will see just some of its two million acres of timber. Avoid the drunks and read the roadside signs. Visit the local museums. You will learn enough about logging and milling to make you feel good about Rayonier and its 3% dividend yield. Then fly to Atlanta; drive to Miami. Buy Ryan's Family Steak Houses and sample from their many locations which you can find at their website: www.ryansinc.com. En route you will like your steaks, your stocks and see a lot more Rayonier land and lumber. The world isn't as bad as people fear. It is time to buy the fear. **BM**

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