

Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive KEN FISHER says fixed income investments are not as low risk as people assume and forecasts trouble ahead for the bond market as a whole

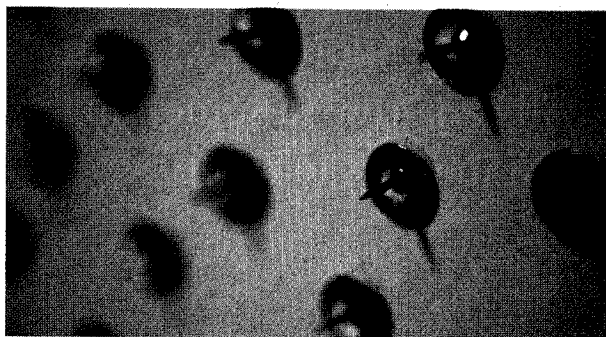
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Is the bond bubble next in line to burst?

The next bursting bubble? That's easy – bonds. Frightened by three years of stock implosion, folks forget fixed income is risky too. Nowadays bond managers are heroes. Pimco's Bill Gross, often called the greatest bond manager, maybe ever, is, like Warren Buffett, suddenly being revered as a stockmarket seer. He now self-servingly sees stocks cratering. A tad late. This, after arguably history's greatest 20-year bond run ever.

If a 20-year stupendous stock run led to that bubble bursting, then why not now with bonds? It's simple maths. A 4% yield hiccup on 30-year US bonds – which is easy to envisage over a business cycle and has happened often before – causes a one-year 40% total return implosion. That's almost as big as the overall world stockmarket's three-year drop. On a 10-year gilt? It causes a 22% drop, as much as stocks are off this year – and folks hate that. Note the US has had few five-year periods where there wasn't at least one long-term rate rise, some time, of at least 2%. That causes a one-year 20% total return cliff.

Some time ago politicians funded future expenses through huge deficits that were partially paid by central bank money creation. As inflation fears ran rampant, one generation of politicians finally folded to another vowing inflation inoculation and disinflationary money policies. Two decades later most western nations again print money madly without inflation insecurity but with fear of a frail economy – usually at 5% to 10% annual rates.



Note an 8% money creation in an economy growing 2% eventually causes 6% inflationary forces. Bond holders will then demand an after-tax premium on top, forcing rates upwards of 8% eventually, any way you figure it – and from there comes the above-mentioned 4% long-term rate hiccup.

Politicians – whether Blair here, Bush there, or Hussein until he retires to the Riviera – all hope to spend money somehow, someway. Recall the Greek origin of the word, "politics": "poli" meaning many, and "tics" meaning small blood-sucking creatures. And money is the blood on which politics thrives. Rates were 16% 21 years ago. Except briefly in 1990 when the UK entered the ERM, the European Exchange Rate Mechanism, UK rates marched in near perfect lock-step with US rates and are mightily impacted by US political forces. We need not retread 16% rates but this decade is overwhelmingly likely to see 8% rates sometime, and that kills bonds deader than Elvis. So what to do?

When this has occurred before, stocks still performed pretty well. After

the biggest and longest global equity bear market since the 1930s it is likely that the rest of this decade will do OK overall for stocks, too, just as the bond bubble bursts. So buy a package of stocks with a competitive dividend yield now but an earnings yield – earnings to price (E/P) rather than price to earnings (P/E) – that beats bond yields. Future revenue and profit growth will more than take care of the rest.

Here are some possibilities. The integrated oil firm, Amerada Hess, with a dividend of 2% and an E/P of 12%; US railroad firms, CSX, with a dividend of 1.5% and an E/P of 8%, and Union Pacific with a dividend of 1.4% and an E/P of 8%, inorganic chemical leader, Dow Chemical, with a dividend of 4.9% and a next-year E/P of 5%, electrical component manufacturer, Emerson Electric, with a dividend of 3.5% and a next-year E/P of 5%, auto parts distributor, Genuine Parts, with a dividend of 3.8% and an E/P of 7%, energy services and equipment maker, Halliburton, with a dividend of 4% and an E/P of 6%, consumer food vendor, H.J. Heinz, with a dividend of 4.9% and an E/P of 8%, breakfast cereals specialist, Kellogg, with a dividend of 3% and an E/P of 5%, the US's largest department store chain, May Department Stores, with a dividend of 4% and an E/P of 10%, Nestlé, with a dividend yield of 2% and an E/P of 6% and, finally, global food retailer, Royal Ahold, with a dividend yield of 4% and an E/P of 14%. BMA

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