

Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive **KEN FISHER** argues that market sentiment rose too much at the end of 2001 – with the result that 2002 now looks likely to be another bearish year

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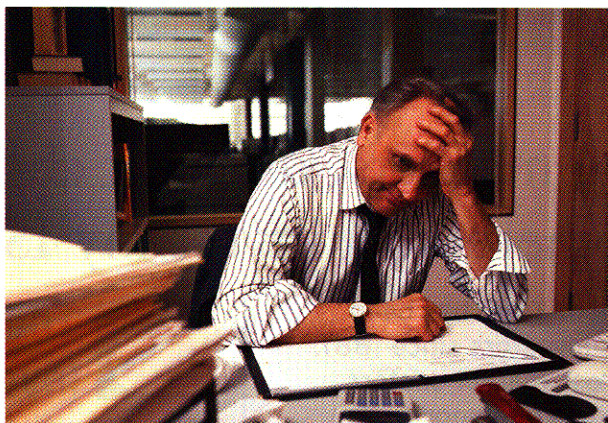
After careful analysis the super-bears have it

Contrary to the expectations in last month's column, my finally-completed 2002 forecast calls for a negative 5% return for the S&P 500 index, with the most pain in the late spring, and a rally thereafter. At the bottom, I expect the S&P to break below 900. That means a 22% drop, followed by a 22% rise in the back of the year.

The Nasdaq Composite index should lose 12% for the year and break 1350 in the spring. The Russell 2000, reflecting the performance of US small stocks, should have a positive 3% annual return, leading the pack, but still be down 20% in the spring. And MSCI's EAFE index, reflecting the total non-US market, should lose 10% for the year. The whole world, reflected by the MSCI World index, should lose roughly 7%. And the FTSE All-Share should fairly well mimic the S&P 500 all year.

Why? Sentiment increased far too much in the fourth quarter for 2002 to be a positive year. Last month, I said I expected the first quarter to be negative but the year to be positive. But I also said – based on how I forecast, which I detailed in my April 2001 column – that it was weeks too early to complete the forecast.

My methodology is based on obtaining a proxy of aggregate demand for stocks from a composite survey of the outlook of professional forecasters of all varieties. My firm builds the survey in December since that is when most forecasters get their numbers out – so you have the broadest base to build a representative survey from.



What is this methodology and why is it valid? Formally, the market is a discounter of all known information. Professionals as a group have access to a body of information that is a very good proxy for all known information. What they can agree will happen is, by definition, that which already has been priced into markets and therefore cannot occur in future pricing. So we survey forecasters, see what they forecast, build bell curves out of it and know that the middle of the bell curve won't happen. Using stocks, long and short-term interest rates, several major currencies and 30 years of data, the middle of the bell curves have never actually ended up being penetrated by the market's final return.

So, then, you look at what forecasters don't forecast and contemplate those possibilities, reject what you can, and what you can't reject is the market's most likely outcome.

This year, in the fourth quarter, sentiment moved markedly more bullish.

Look at what forecasters don't forecast and contemplate those possibilities – what you can't reject is the market's most likely outcome

Late in the 1999-2000 period, sentiment started getting more bullish after years of having been too dour relative to actual market results. With the 2000 and 2001 declines, sentiment steadily moved more morose. But autumn's market upturn brought a big swell of optimism.

Too much! At the end of the year, forecasters had, on average, come to expect a 17% S&P 500 return in 2002 – said differently, a nicely but not hugely above-average year. This year's bell curve was continuous from forecasts of 40% all the way down to a -2% return. From there, no forecasts exist until you hit a small pocket of super-bears who expected returns from -11% to -20%. Hence, the market will come in either below -20%, above +37%, or in the hole from -2% to -10%.

A -20% – or worse – return isn't likely, particularly after two negative years in a row. You could see my arguments from last month on this. A return above 40% would be rare too, since that doesn't often happen in history and is very hard to envisage starting from a world of optimistic sentiment. Hence, I come to the notion that the bear market has one more down-leg, leading to the final collapse of sentiment, signifying the final end of the bear market – and that the subsequent up move won't be quite enough to get positive for the whole year.

Sentiment isn't uniform globally. Continental European strategists, having seen a rougher year, are more pessimistic than US or UK strategists. But, overall, folks are too optimistic. It remains time to be defensive. **BM**