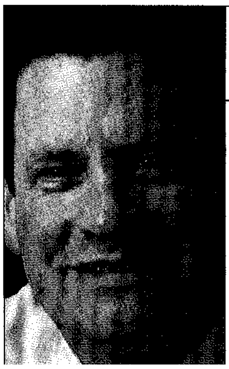

Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive **KEN FISHER** uses his tried and tested forecasting methodology to predict a positive year for the stockmarket in 2003

High hopes for 2003

Expect 2003 to be a great stockmarket year – among the best ever. That folks can't see it makes it more likely. The S&P 500 should rise maybe 40%. My February 2002 column, entitled "After careful analysis the super-bears have it", made the case for a sorry 2002. In it I laid out my forecasting methodology which remains almost unchanged.

To quote from last year's article: "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."

Basically you look for where there are clusters of agreement as to what will happen and know they won't happen – but something else will and you pick and choose among those something-else options. That column stated that in 2002 the S&P 500 could only be "either below -20%, above +37%, or in the hole from -2% to -10%."

In considering between those three I bet on the last and was wrong. It came in at -20%, as we all now know. But my error in picking among the three did not make the methodology wrong, just me. That I returned into the market a few months early (July's column), was also a function of me imperfectly implementing good methodology.

This year, rather than lumping everyone together, we created four subgroups. Interestingly each group bunched tightly while overlapping and varying from the others. The first group – investment banking and "sell-side" broking firms – is overwhelmingly bullish, spanning from a few small negative forecasts up to positive 35% with an average 18% expected return.

Group two – large and well-known "buy-side" money management firms – is materially less optimistic. Group three – small and obscure money managers and hedge funds – was pessimistic, expecting a slightly negative return on average and with forecasts as low as -44%.

For comparison, we sampled individual investors, too. They average slightly more bearish still. But, as opposed to last year where I found a small hole where no professional expected returns, hence three possible outcomes, high, low and the hole, this year when aggregating the groups together the array is continuous – a spectrum of expected returns from +35% to -44%. So, I conclude the market will be above or below that span. Each is intuitively unlikely yet equally likely. Everything in between is inconsistent with finance theory and history.

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A simple, little-known fact is that average stockmarket years are uncommon. Folks know that stocks have returned about 10% a year on average and think returns of 5% to 15% are normal. Wrong. In major countries, that happens in less than 25% of all years. Most years the market does markedly more or less – a comment on market volatility. Of course, few years are +35% or -45%. But in choosing between those two, this year I see an up year.

Why? Forecasters overwhelmingly expect interest rates to rise, a lot – so they won't. And that will be unexpectedly good news. Add to that central banks printing money like drunken sailors and the system will be awash in liquidity. Recessions everywhere will have had time to unwind by December. And Iraq will then be long past.

Next month, I'll detail a big, secret fact no one knows that is super bullish coming from the US. But meanwhile buy stocks like the US's agricultural commodity giant, Archer Daniels Midland, or the largest department store retailer, May Department Stores, or number two, Federated Department Stores. All three are cheap. Nucor has had a tough few years but is still the world's most efficient major steelmaker and will bounce back. Chow down on global cereal powerhouse, Kellogg. While waiting, its 3% dividend will be tasty. BM

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