

Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive KEN FISHER is positive on the outlook for 2003 and explains why historical evidence shows that US presidents' third terms are always good for the economy

Relying on Bush to make things better

My prior brief comments about the power of the third years of US Presidents' terms have been met with some scepticism by certain readers. But those who don't see this cycle's power aren't seeing 2003 clearly. As we face President Bush's third year, it is useful to contemplate this little-known cycle to fathom its fundamental causality.

First, consider simple US history. Think of full presidential terms – for example, 1973 to 1976 was the Nixon/Ford term. Then take the S&P 500's annual numbers since 1926 inception. There have been more negative than positive first years by a factor of 10 to 9 and almost as many negative second years, counting 8 to 12.

By contrast, the entire back half of all President's terms suffered only five negative years ever – 1931 to 1932, leading to the Great Depression's bottom, 1939 to 1940, as the US approached the Second World War, and 2000 as the technology bubble first burst. All of these five are big, unusual negative phenomena. That last negative third year was all the way back in 1939 and was down merely 0.4%. The third year US median return? 22%. They have traditionally been up big.

What causes this? First, as you know, normal people hate losses much more than they like gains – in fact, more than twice as much. Second, Presidents always plan for the absolute historical political rule that President Bush just spectacularly upended. Normally a President's party loses at least some

power in the US's mid-term elections. On day one of a President's term he knows that whatever is his toughest legislation must be passed in his first two years or it won't pass later.

Essentially, all major US legislation attempting to redistribute wealth or property rights happens in the first half of a President's term. If they take from these to give to those – whoever they are – those taken from hate it lots more than recipients like it. This is true of property rights even more than wealth itself.

Core and stable property rights are basic to the success capitalism creates. Without them capitalism never thrives long. When government threatens property rights (or wealth) materially, it scares the foundation of free markets – hence it scares the stockmarket.

Examples? Here are two of many: 1969, the first year of Nixon's first term, he gave the US the Environmental Protection Agency, drastically changing property rights. In 1994, Clinton's second year, he attempted, but failed, to nationalise healthcare.

In Presidential third years all this stops as administrations focus on campaigning for the next election rather than legislating. Talk, not action. Despite Bush's mid-election upset of tradition, he still has a paper-thin Congressional majority. His 2003 actions will be ordinary as he focuses on building his political capital via the 2004 election rather than spending his it on heavy legislation. The prime goal will be to get re-elected with a bigger

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Congressional majority in 2004 and then he can legislate heavily in 2005 and 2006 when politically he has little to lose.

Hence, the traditional third year magic will likely endure and 2003 will be good indeed, particularly after three negative years.

The following stocks should help with 2003. Leading US glass, chemical and industrial coatings manufacturer, PPG Industries, uses high market share and low-cost production as effective strategic weapons against competition – and is too cheap at one times revenue with a 3.6% dividend yield.

Global energy drilling equipment leader, Halliburton, sells for 60% of revenue with a 3.1% dividend yield. If inflation picks up unexpectedly, it will boost both stocks materially.

Eastman Kodak was a glamour stock for decades and now has been a dog for a long time. But this dog will have its day. Still the world's photography powerhouse, the stock is a steal at 80% of revenue with a 4.5% dividend yield.

Finally, look across the channel at French telecom equipment maker, Alcatel. In a beat-up field, Alcatel has done relatively well while its stock, plagued by the tech bubble collapsing around it, plunged 94%. At 30% of revenue with a 2.4% dividend yield, it is now worth owning. Meanwhile, clothes retailer The Gap, which I recommended buying in our November 2002 issue, has gone up too much, too fast, and can be sold. 

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