



Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and Fisher Investments chief executive **KEN FISHER** says investors tend to overlook big upward moves in the stockmarket because they forget just how large bull markets can actually be

Don't underestimate the size of the bulls' stampede

Last month I discussed how the market is more volatile – both up and down – than investors envisage. But another reason folks can't foresee a big stockmarket up-move is that they forget how big bull markets are – even when they're pretty small.

In the US's last 100 years, the average return in the first 36 months after a drop of 30% or more from that bottom or down 40%, whichever came first, was 67%. That's big. In the same time period, bonds averaged just 16%. The UK saw similar numbers but the variance within returns was bigger. Still, bull markets are bigger than our minds envisage.

Another way to see this is to ask, after three years in a row where returns were below their long-term average, what has happened before in the US and UK? Answer, in the last 100 years in the US whenever each of three years running has been below average, the next five-year return was positive with only one exception (and that only down 4% in the 1910-12 period). The subsequent 10-year returns were always positive. The average five and 10-year returns were 99% and 191%. Big numbers.

By contrast, the bond only returned 26% and 47% over the same time periods – much less. The UK numbers were very similar. Of course this time it was worse. The last three years were not only all below average, they were all negative. When this has happened, the subsequent five and 10-year returns were bigger still in both the Uniteds. Big bear markets lead to big up-moves – they always have.

Some will say stocks aren't cheap enough. Wrong! Fixed income returns are low around the world. Buy a 10-year Gilt – get 4.7% a year. That's it. Based



on 2003 earnings the inverse of the price/earnings ratio, the earnings yield, is higher all around the western world and particularly in the US than the comparable fixed income return. But in the next decade the earnings will grow somewhat.

In the US, revenue of public companies grew in the last 20 years by roughly tripling while earnings bounced around erratically, averaging 4.9% net after tax. Currently they are about 2.5%. So in the next decade, revenue will grow some (you can debate how much – not me). And profit margins will gyrate around some long-term average, a bit above or below that 4.9%. Either way, earnings will be a lot higher in 10 years than now.

Earnings will be a lot higher in 10 years than now. And stocks will move before the earnings

And stocks, as they always do, will move before the earnings. Hence plenty of justification for owning stocks in 2003.

As some readers may know I got my first success two decades ago providing the rationalisation and research behind today's commonly-fathomed price/sales ratio, working like a price/earnings ratio but using total corporate turnover where the price/earnings ratio uses earnings. In the US and UK, the market's price sales ratio is a little below the average of its history over the last 50 years. By contrast, interest rates are historically low. So, adjusting the price/sales ratio for interest rates, the only time stocks have actually been "cheaper" in the last 50 years was in 1982. How cheap do you need?

The US's Constellation Brands is one of the world's leading makers and distributors of premium liquor products across the varietal board, sporting more than 200 name brands. But it is also cheap at a price/earnings ratio of 12 and at 80% of annual revenue. Folks fear the now legendarily weak consumer who keeps spending and won't quit drinking.

Similarly cheap for similar fears but with a similar broad and great product line is Electrolux from Sweden. With a price/earnings ratio of 10 and what I would expect to be a 4% dividend yield on this year's dividends, it is also arguably the world's leader in consumer appliances.

Finally, right here in the UK, try BOC Group. Investors just can't see any kind of industrial surge, which is why the stock is down. Being too pessimistic they will likely miss the move here in one of the world's leaders in industrial gases. BM

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