Portfolio strategy: Ken Fisher

Forbe's Magazine's Portfolio Strategy columnist and **Fisher Investments** chief executive KEN FISHER argues that, contrary to popular belief, it is possible to see a big bull market off the back of high price to earnings ratios – so we should not be afraid to buy

P/E ratios are big in mythology, tiny in truth

You can't have a big bull market from such high price to earnings ratios (P/Es), right? Wrong! Over the last 40 years the S&P 500 index averaged 12% annually. Back in 1962-1963, its P/E was 18, just like now. The 10-year bond was 5%, like now. If these levels didn't stop stocks in those four decades, why now? But, you say, what if you only have five years? Consider 1963-1968. Big. Only one year? Try 1964. 16%. Or 1965. 13%.

Take every period where high P/E markets fizzled, like 2000-2002. There are comparable ones and of roughly similar frequency where they did well. P/E ratios are a lousy market forecaster. Big in mythology, tiny in truth. Even adjusting for interest rates doesn't help in the short to intermediate term. Overall, investors won't learn this. You can. Take advantage of it. When people fear P/Es, like now, the fear is bullish. Buy it. They weren't fearful in 2000.

Sentiment indices are usually, though not always, mythological. Much is made of the S&P 500's VIX, the basic put and call, options-based, volatility index used to measure sentiment. Folklore is it's now too low, too long, reflecting excess optimism, too much for continued stock advances.

VIX has coincided with enough dramatic market reversals to convince the anecdotally inclined. But it misses lots and has poor overall statistics. If we lag the S&P 500 to it for one week – or one, three, six, 12 or 24 months out, any of them – its correlation coefficient is basically zero. That means VIX actually explains and predicts nothing. Zero. Who knew? Anyone analytical enough to question and do the stats to check that the mythology lacked reality – in other words, almost no one.

Other false sentiment indicators? Indices like that of the American Association of Individual Investors for do-it-yourselfers – and the widely-watched Investor's Intelligence data on American newsletter writers. They're useless – Meir Statman of Santa Clara University and I demonstrated that for those two statistically at length and in detail in Spring 2000's *Journal of Portfolio Management*. People heed these indices but their statistics prove there is nothing there. Statistically, they are non-predictors. So, when their movements create fear, it's bullish.

September and October are the worst months for stocks, right? This is like last spring's "Sell in May and go away" tripe – costly if heeded. If you swallowed that myth, a good seasonal time should be soon. Probably will be. Septembers and Octobers within 24 months of a major market bottom have been overwhelmingly positive. That is, cyclical factors usually override seasonal factors.

The wall of worry a bull market climbs will always find more to fret about next month to keep money on the sidelines, withholding until later, fuelling the bull market until the last fool falls over the top. Count on it. Meanwhile, good surprises are discounted or ignored. Who notices Sweden cutting capital gains taxes or other signs of continental European economic reform? It rarely makes our news. Equities will be fine for the next few years. Stocks will have moved steadily ahead of news.

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So enjoy it with stocks such as the following. UK-based drug and healthcare firm Amersham has a leading position in diagnostic imaging agents that will be big. It is among the cheaper stocks in biotech and well-run. Bearingpoint in the US is KPMG's consulting operation spun off in 2000 and has since been a doggy stock. Corporate consulting will be hot in coming years. At six times cashflow it is dirt-cheap growth.

Take a spin with International Speedway. It is both the top racetracks and the top independent sports radio network in the US. You can't beat these properties. It grows nicely and isn't expensive at market-like valuations.

Try toying with Leapfrog Enterprises, the world's most innovative toymaker. I've known its founder, Mike Wood for a decade and am confident his crew will keep leaping ahead of its peers. It isn't cheap but it is changing the way kids play. Finally, Church & Dwight has great brand names in a well-run growing firm that isn't too expensive at a market-like P/E. Among others it includes Arm & Hammer, Brillo pads and Sno Bol. BM

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