Ken Fisher
CEO of Fisher Investments
& Bestselling Author
On Facing
“The Great Humiliator”

Hedge Fund Stampede
How Much Can
The Markets Bear?

World Market Watch:
India, Israel, China

PLUS: EQUITIES December
Conference Companies
UP over 28%
If you are looking for confirmation of your false investment beliefs, look elsewhere. Ken Fisher would rather kindly direct you on a higher path. Absolution is possible, if you understand *The Only Three Questions That Count*. Prepare to renounce every investment idea you have and bow down before the market, or as he calls it, “The Great Humilator.” Before you rise to face it, make sure you’ve read the book. It could be your only guide.

BY GREGORY BERGMAN AND ANTHONY W. HADDAD
INTERVIEW BY DAVID BERNARD
**Bernard:** How’s the book doing?

**Fisher:** The book’s doing very well. It’s been bouncing around in the last few weeks between number 80 and number 19 out of all books on Amazon. And it’s been running between four and 15 in the business category.

**Bernard:** In it, you talk about how the P/E ratio has no value the way it’s used.

**Fisher:** It’s something that I started pushing a long time ago that’s never been publicly accepted. In the first chapter I show you that P/Es tell you nothing about risk or return. I take you through the history and show you that all P/E levels have historically shown the same results. The same ups, the same downs.

**Bernard:** What about earning yields?

**Fisher:** Right. I teach people to take the P/E and flip it into an E/P. Think of a company that has a P/E of 15. This means an earnings yield of 6%. (That’s the company’s after-tax annualized cost of raising expansion capital by selling stock.) Its other option is to go out and borrow ten year money at about 6%. That’s a pre-tax number. After tax it’s about 4%. So the company borrows money at 4%, and it buys back its own stock with a 6% earnings yield. The earning per share goes up immediately. It’s this function that’s causing us to have all time record levels of cash right now.

**Bernard:** What does that mean for the market?

**Fisher:** Normally, the earnings yield in the market has been below the bond yield because there’s been a presumption of future growth. When you buy a bond and you hold it for ten years, you get the ten-year bond rate. But when you buy the market and you hold it for ten years, you don’t get today’s earnings yield. You get the average of future earnings. Since there’s some growth, the future average earnings yield is higher than today’s earnings yield. Starting in 2003, for the first time in every major country, the earnings yield is above the bond yield. This process allows companies to borrow long-term debt to buy back their stock or take over their competitor. This makes their earnings per share go up. It’s this feature that’s driving the market today. People don’t understand.

**Bernard:** This is very timely because of the record levels of private equity deals and stock buybacks last year.

**Fisher:** The last time this happened was back in the 1960s, which led to the conglomerate. But it didn’t happen all around the world. Now it is. This is driving stock buybacks, private equity, and the cash based public takeovers. People don’t appreciate the implications. This doesn’t go away as long as that earnings yield to bond yield spread is there. The longer we go on, the more people figure out how to play it.

**Bernard:** How long do you see this continuing?

**Fisher:** It will continue until the earnings yield/bond yield gap closes. Either the stock market goes up, long-term interest rates go up, earnings fall, or you have some combination.

**Bernard:** How do you see 2007 turning out for the markets?

**Fisher:** This should be a bigger year than people think. Forecasters are saying gains of 7 to 12%. Global equities could be up 20 to 30%.

**Bernard:** What’s your overall investment philosophy?

**Fisher:** You’re not going to like what I’m going to tell you here. People have always believed that the kind of equity they invest in is superior to other kinds. ‘I’m a growth guy,’ ‘I’m a value guy,’ ‘I’m a small cap guy,’ ‘I’m an emerging markets guy.’ The fact of the matter is GDP, is the same as America’s. No one can argue that this makes the dollar weak, and this makes the Sterling strong.

This is a perfect example of the global approach teaching you that something everyone says about America is false.

**Bernard:** Why do people see the trade deficit this way?

**Fisher:** People misunderstand what causes it. The trade deficit is always marketed in America and around the world as a problem.

**Bernard:** So the trade deficit good?

**Fisher:** Yes. When we have a current account deficit, it means cash flow is coming to America. The current account deficit happens first. Once the money is here and gets spent, that creates...
The savings rate data do not include capital gains, which is the main way people save here. If you believe the savings rate data, Bill Gates became the richest person in the world by never saving.

In addition, there is an accounting charge in the savings rate data called the imputed rent charge. This is an estimate the government makes of how much homeowners should be paying to rent their homes from themselves. The theoretical justification for this is that it's kind of a depreciation replacement. In 2006, that charge was $1 trillion. GDP was $13 trillion. That's 7% of GDP right there! America saves more than anybody in the world. The savings rate data doesn't measure it.

Once you start getting these concepts, you are less likely to buy into that 'we're all going to die because of the trade deficit' nonsense. There's this unfounded fear that a terrible day of reckoning is coming.

Bernard: How does this reasoning apply to the markets?
Fisher: In 2005, Katrina wiped out New Orleans. Investors thought that this would be bad for the markets. The fact of the matter is that it's pretty easy to measure this in two ways. One is if it wiped out the whole state of Louisiana, what percent of U.S. GDP is that? The whole state is nine-tenths of 1% of GDP. So if GDP was going to go up 4% anyway, without Louisiana it would grow 3%. Another way is to go back and see what happened to the stock market when San Francisco was wiped out. The stock market went straight up right through the whole thing. It never blinked. If a comparable city was wiped out before and nothing happened, chances are nothing happens this time.

Take avian bird flu. Let's say it does become a pandemic, how would you measure that? Go back to the 1918 pandemic and see what happened to the stock market. I'll tell you what happened. Nothing. Not a thing. So no more 'what if?'. The market doesn't care.

Bernard: Is this book going to teach people to relearn how to think?
Fisher: There are questions in the book that are designed to do just that.

They ask this guy, and that guy, and the other guy. And, if they all agree, then it must be true. But in capital markets if they all agree, it's already priced in.

Bernard: Jim Cramer wrote the forward to your book. How would you compare your teaching styles?
Fisher: Jim provides a broad level introductory education to people who otherwise don't really know very much about investing. They're going to Jim because he's entertaining. Jim isn't trying to go into the kind of things that I'm doing here, although Jim is laudatory about my book, as you'll read in the forward. I have to say, Jim would be great at whatever he wants to do. He's got that intensity. That's made him the phenomenon that he is. There's no one out there like him.

Bernard: When did you start Fisher

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