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# Ken Fisher

## CEO of Fisher Investments & Bestselling Author On Facing "The Great Humiliator"

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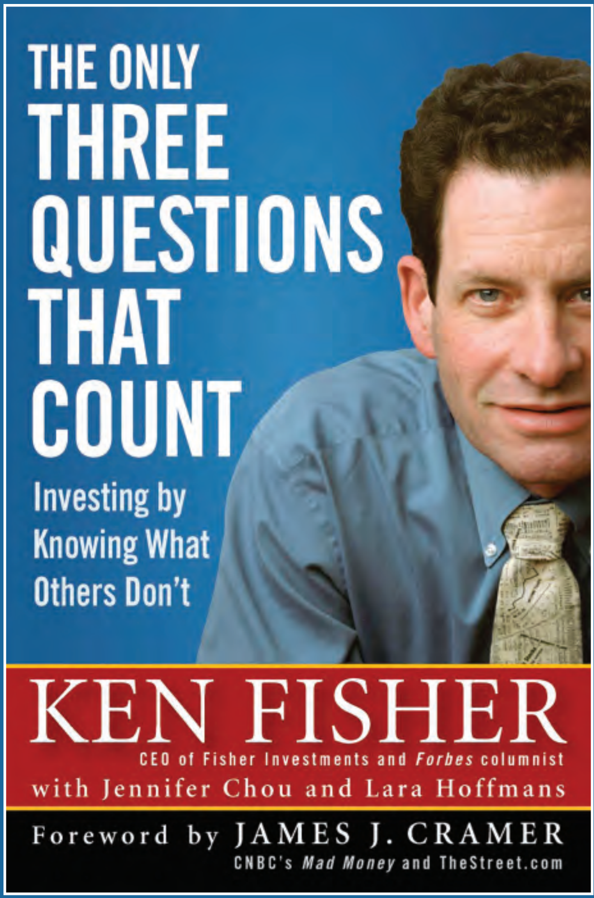



# Ken Fisher On Facing The Great Humiliator

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 these people share a spiritual core with Osama Bin Laden.

**Bernard:** What do you mean?

**Fisher:** They're narrow minded fanatics. And, they miss the big picture. In the long term all major categories of equity must have almost identical real risk adjusted returns. Because if you don't believe that, you believe that a category of equity is more powerful than capitalism itself.

**Bernard:** Right. What strategies do you employ?

**Fisher:** We do whatever it takes. The goal is to do better than the global equity return. One of the things that I endlessly preach in the book is that you can't really even understand America today if you don't spend your time thinking globally. The world is the laboratory where you learn how to engage everything local. Take the trade deficit. People always say that the trade deficit will cause the dollar to be weak. Right now, the deficit is a little more than 5% of GDP, and this trend that disturbs people.

But if you look at Britain, you'll see that its trade deficit, as a percentage of 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?

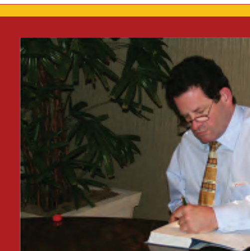
**Fisher:** People misunderstand what causes it. The trade deficit is always marketed in America and around the world as a problem.

**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 cre-







ates the trade deficit. Current account deficits show that the world thinks it's better to invest in America than to invest in Africa. It's better to invest in America than to invest in Germany. Germany gets the surplus. We get the deficit. That money is actually good for America.

**Bernard:** So in Germany, it's the opposite.

**Fisher:** Yes. A healthy surplus is not good. Let me give you a parallel. You've heard that Americans have a 0% savings rate. This is true if you use the government savings rate data, which is a broken index.

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. 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 ifs'. 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

> **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%.**

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 They serve as a guide. My first question is, "What do you believe that's actually false?" It turns out that more than half of what we've been taught to believe is myth. Another question is, "What can you fathom that other people can't." And then I ask, "What's my brain doing to blindside me right now and make me not see this circumstance correctly, make me not do this right?" If answered, people have begun to think for themselves. And that's the key to successful investing.

**Bernard:** How has the media responded to the book?

**Fisher:** Journalists have really embraced my book despite the fact that it's critical of them. Their reaction has made me think that they have often been misguided about the markets.

**Bernard:** What about financial journalists?

**Fisher:** Financial journalists usually don't have a background or any training in finance. They aren't typically very deep in the field, so it's easy for them to unintentionally pass along myth. These aren't people that were trained to be specialists. They report on what they see. Investments and where did it come from?

**Fisher:** I went to work for my father right out of college. I decided he and I weren't going to get along if we worked together. So, I went off on my own way and finally I found my place doing asset management. I just started slowly building up the firm. The firm operated as a sole proprietorship from the late 1970s until 1986, when I incorporated it. At that point we were still tiny. By 1992, we were $1 billion and today we're $35 billion.

**Bernard:** Finally, what are your thoughts on the small cap-markets?

**Fisher:** I think all equities are blessed. Small and mid-caps are no different. I continue believe that this year the value side will continue to beat the market as a whole because that's where companies can be taken over, and that's the place where companies can borrow money and buy back their own stock. In the long term, small, big, growth and value—it's all the same. The Great Humiliator doesn't make these distinctions, and neither should you. The best way to face it? *The Only Three Questions That Count.*