

An Historic Opportunity

I am a student of history, whether it's the history of the stock market, the economy, the country, the development of civilization, politics, or just about any other subject. I believe very strongly that by studying history, we can learn to better deal with the present, and the future. I believe this because history, as with the present and the future, is driven by human behavior, and people don't change. We are motivated by the same factors today as the Greeks, the Romans, the Europeans, and I would say every other people throughout history.

Because history tends to repeat itself, and because human behavior has a direct and significant impact on history, I believe, by understanding history, I can make better decisions for my clients, in terms of investing their wealth. I see the current stock market valuation as a significant opportunity; one which we will not likely see again for many years to come. For some of us, it may very well be the best opportunity we will see for the rest of our lives.

If we look beyond the November 2008 lows, stocks are down to levels we have not seen since 1997. But, on a valuation basis, if you compare stocks to Gross Domestic Product (GDP)—the value of all goods and services produced in the United States within one calendar year—which is a useful and relevant measure of the value of the stock market, stocks today are much cheaper than they were even in 1997. While this does not mean that stocks cannot go even lower, it should offer some perspective in terms of how cheap stocks are today. For comparison, in 1997 the value of the S&P 500 represented 88 percent of U.S. GDP. Today, the S&P 500 only represents about 50% of 2009 estimated GDP. We would have to go back as far as 1994 to find a time when the S&P 500's value was as low in relation to GDP as it is today.

In addition to the GDP comparison, stocks are incredibly cheap in comparison to all other asset classes, whether we look at bonds, commodities, real estate, or even cash. Although real estate prices have come down substantially, they are still well above where they were at the bottom of the last real estate bear market, back in 1993 through 1996. Commodities have come down big from their highs in the first half of 2008, but they are still elevated, and I would expect commodity prices to continue to decline throughout 2009 and beyond. Although there are some opportunities within the bond segment, treasuries are at yields lower than we have seen over the past sixty years. Since bond prices move in the opposite direction as yields, treasury prices are at historically high levels, and I believe are in a massive bubble, similar to the bubbles we saw in oil and real estate over the past year or so. Even cash is expensive right now, with most money-markets paying virtually zero percent returns at present. So, when we compare stocks to any of these other assets, the valuations for stocks look very attractive.

Time provides perspective. It seems so obvious now that oil was in a speculative bubble at mid-year last year, when oil was trading above \$140 per barrel. But, at the time, with so-called experts like T. Boone Pickens pounding the table every day, saying oil was going to \$200 or higher, it was easy for most people to believe that oil was never going to decline in price. Now we know that there was no shortage of oil, and that speculators like Boone Pickens were simply talking oil prices up. Boone Pickens' \$2 billion fund lost substantially all of its value in the second half of 2008, and we don't see him on television anymore.

Real estate prices back in 1993 through 1996 were incredibly cheap; we all realize that now. It seems so obvious to us with the benefit of time and perspective. But, at the time, between 1993 and 1996, no one was buying real estate. We had just been through a major recession in 1991 and 1992, and real estate seemed like it would never improve. Looking back, it seems so obvious that this was the perfect time to buy, and those that had the foresight to do so have benefited tremendously, again, even after the latest price declines from the recent highs.

The point of all of this is simply that when you are in the midst of one of these major economic episodes it is very difficult to see the forest for the trees—to see the opportunities for making wise investments—when there is so much negativity. Today, we have people like economist Nouriel Roubini, AKA Dr. Doom, coming out almost daily with another doomsday prognostication that the economy is in a depression that will last for years and that the only answer to the financial crisis is for the government to nationalize the major banks. With the constant bombardment of negativity in the media, it's no wonder that investors are clamoring for cash and gold right now.

I believe, based on the current valuations for stocks, and comparing stocks to every other asset class, that stocks represent the best buying opportunity we have seen since the early 1990s, and probably the best opportunity we will see for at least a generation. For some of us, this will very likely be the best opportunity, and perhaps the only opportunity, to buy the highest quality U.S.-based companies at valuations comparable to micro-cap companies or international companies, with negative cashflows and questionable financials.

I believe that markets are driven by human behavior, and that people are motivated by the same factors generation to generation. This is one key reason why we have a repeating cycle of boom followed by bust, about every twenty years or so, as each new generation must make their own mistakes. A generation is born, they grow up, they make their own money, and then they invest that money, often without the benefit of experience or perspective. Again, because it is human nature, this new generation must make their own mistakes, and therefore we are forced to repeat the same overexpansion of debt and leverage, and to suffer the consequences in the form of deleveraging and economic contraction.

However, those who can take a big picture perspective and can learn from history, have a unique opportunity, in my opinion, to buy the stocks of great companies for dirt cheap prices today, if they can stand the daily negativity that is surely going to persist for some time to come. But, for those long-term investors who can ignore the negativity and can see the forest of giant sequoias, opportunities abound. For the rest, I believe they will be kicking themselves in a few years, when they can look back and see how obvious today's opportunities in the stock market appear with some perspective.

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