

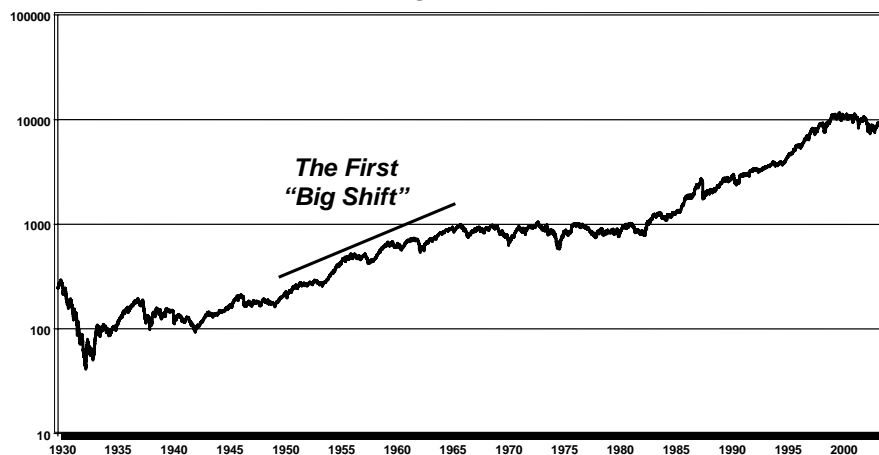
The Individual Investor

C15.0042
Lesson 10
Edward M. Kerschner

The First “Big Shift”

The “Ozzie and Harriet” market of the early 1950s

Dow Jones Industrials Average



E. Kerschner

The First “Big Shift”

The “Ozzie and Harriet” market of the early 1950s

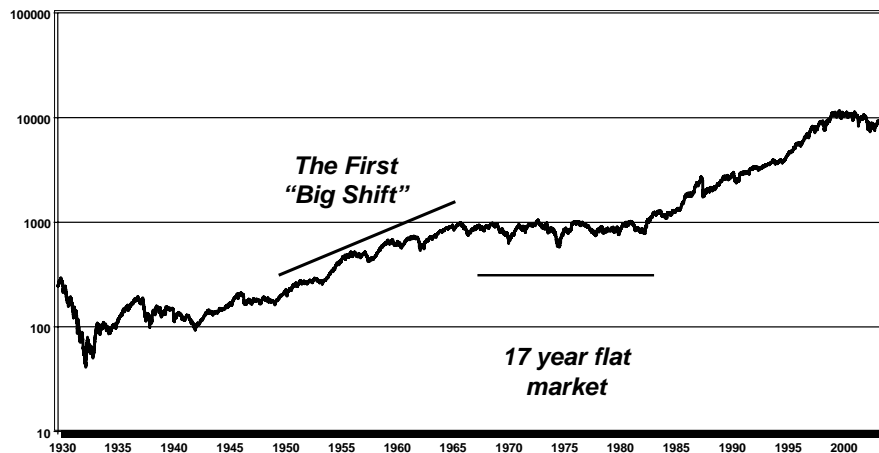
- ◆ Low interest rates at banks. Banks and S&Ls were permitted to pay savers no more than 2.5% until 1957, when the rate went up to 3.5%.
- ◆ T-bill yields averaged 2.1% in the 1950s.
- ◆ 10-year bond yields averaged 2.7% in the 1950s.
- ◆ Real estate was not an attractive investment option as supply was increasing rapidly.
- ◆ 45-54 year old age group was a large and growing segment of the population.
- ◆ Stocks were the best investment, a frightening thought for many investors in the early 1950s who vividly remembered the 1929 crash.
- ◆ 1952-66 bull market was an extremely cautious one. Individual investors owned stocks not to make a killing, but as long-term investments.
- ◆ At start of 1952, DJIA stood at 269; in January 1966, it hit 1000, a level that would not be substantially exceeded until 1983.

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End of first Big Shift

(17 year flat market, 1966 – 1983)

Dow Jones Industrials Average



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End of first Big Shift

(17 year flat market, 1966 – 1983)

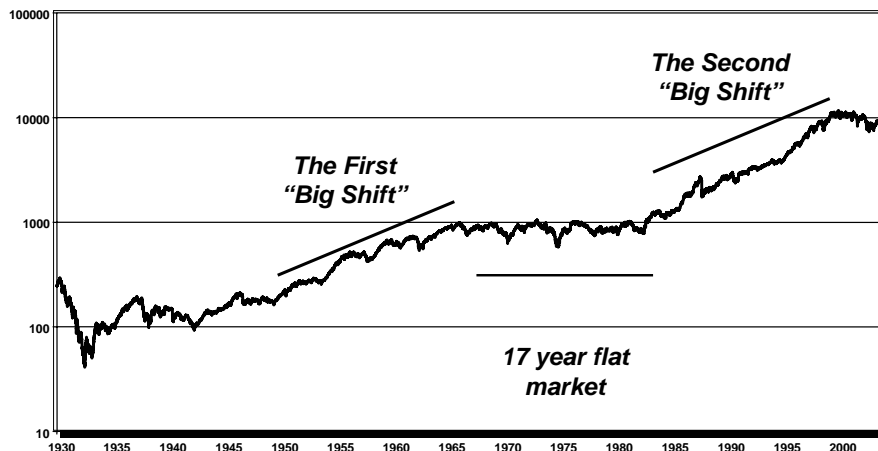
- ◆ **War.** LBJ attempted to fight war on poverty and war in Vietnam without raising taxes. Secular inflation killed the bull market.
- ◆ **Inflation.** Rising inflation produced higher interest rates and lower P/Es and hurt corporate profits because it led to credit crunches (1966), price controls (1971) and recession (1970). OPEC 1973-74. Inflation rose above 10% in 1973.
- ◆ **Financial Phobia.** Even though the stock market tripled in the 1980s, individual investors largely ignored stocks:
 - Good returns from money market funds and bonds
 - Wall Street insider trading
 - Program trading
 - 1987 crash
- ◆ To the extent that individual investors were willing to invest in long-term assets, they preferred bonds to stocks.
- ◆ Demographics. The baby boomers turned 30 in the 1980s, the decade when conspicuous consumption was de rigeur.

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The second “Big Shift”

The 1990s

Dow Jones Industrials Average



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The second “Big Shift”

The 1990s

- ◆ In 1991, we argued that, driven by long-term education and retirement needs as well as a continued low inflation and interest rate environment, individual investors in the 1990s would be big buyers of stocks, just as they were in the 1950s.
- ◆ The environment in 1991: Gulf War, S&L and banking crisis, struggling economy, weak profits, relatively high, although steadily declining, interest rates.
- ◆ Brokerage products would capture much of the \$2.5 trillion in CDs and other traditional bank savings because savers, scared by financial instability at banks, and squeezed by decline in rates, would look for a better place to invest.
- ◆ By 1998, equities share of household financial assets was 43%, surpassing the prior 1968 peak of 39%.
- ◆ Key factors behind second big shift:
 - Absence of war
 - low inflation
 - no financial phobia/strong bull market
 - favorable demographics

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The second “Big Shift”

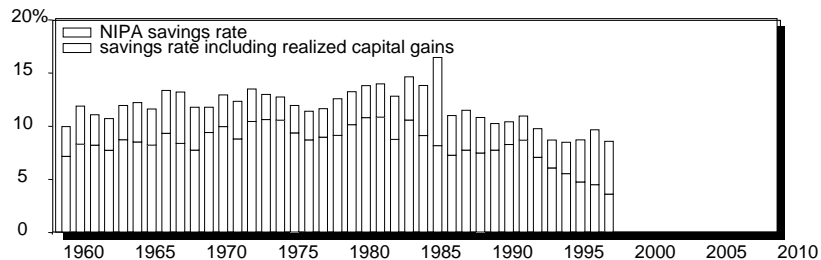
The 1990s

- ◆ Demographics: A close relationship between stocks as a percentage of household financial assets, and percentage of U.S. population aged 45-54.
- ◆ By 1998, equities share of household financial assets was 43%, surpassing the prior 1968 peak of 39%. Refer to the table “Financial Assets of U.S. households” in “The Big Shift—Barely Begun.”
- ◆ Key factors behind second big shift: Absence of war, low inflation, no financial phobia/strong bull market and, perhaps most importantly, favorable demographics.
- ◆ Demographics: A close relationship between stocks as a percentage of household financial assets, and percentage of U.S. population aged 45-54. Refer to “American Age of Affluence” concept that people are living and working longer. “The Gray Wave.”

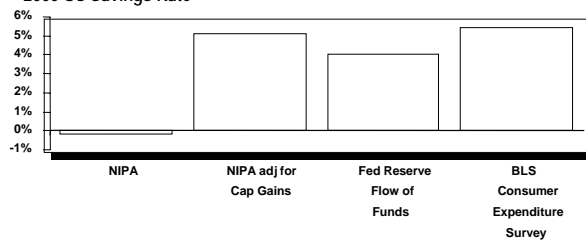
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The second “Big Shift”

The Savings rate . . . Higher than you think?



2000 US Savings Rate



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The Individual Investor and . . .

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78. UBS Warburg acted as financial advisor with respect to the merger of INA into Generali.

80. UBS AG is an issuer of covered warrants for MIB30 shares, as well as Acea, Benetton and Parmalat as underlying shares, all listed on Milan Stock Exchange.

122. UBS Warburg Ltd. is advising Vodafone with regard to the restructuring of J-Phone Group wireless units.

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The Press



ALI RODRIGUEZ HAS RESIGNED as secretary general of the Organization of Petroleum Exporting Countries to become president of Petroleos de Venezuela. OPEC's head of research Adnan Shihab-eldin could take over as secretary general for an interim period, Mr. Rodriguez said.

Extreme-right leader Jean-Marie Le Pen, founder and head of the National Front, has upset Prime Minister Lionel Jospin to qualify for the presidential-election runoff against President Jacques Chirac, according to media projections based on exit polls.

Enron's president and chief operating officer, Jeffrey McMahon, is leaving after barely four months in those posts.

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The Press

In the late '90s, dividend-paying companies -- typically lumbering Old Economy warhorses -- took a back seat to flashier tech bets. But today, these once-dowdy plays can look downright tempting.

Microsoft Chairman Gates will take the stand Monday in an attempt to stave off harsh antitrust penalties sought by nine states. It will be his first appearance in the long-running case.

Ford reorganized its luxury-car business, shuffling some of the group's biggest brand names into different divisions and naming the head of Japanese partner Mazda to run the unit.

The SEC told Compaq to preserve papers relating to its lobbying efforts, as part of a federal probe into Hewlett-Packard's efforts to acquire the computer maker.

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The Press

- **UAL Posts \$510 Million Net Loss**
- **Boeing Beats Dassault in Korea Deal**
- **Japan's NTT to Cut 17,000 Jobs**
- **EU Accuses Auction Houses**
- **Samsung's 1st-Quarter Profit Rose**
- **WorldCom Slashes Sales Guidance**
- **BellSouth's Profit Climbs on Sale**
- **PNC's Net Rose 20% in Quarter**
- **Aon Lowers Profit Target**

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The Press



Long in the Shadows, Dividends Take Stage

By ERIN SCHULTE
THE WALL STREET JOURNAL ONLINE

In the go-go days of the late '90s, dividend-paying companies -- typically lumbering Old Economy standbys -- took a back seat to flashier tech bets as risky plays were amply rewarded.

Because the S&P 500-stock index was rising about 20% annually at the time, dividends looked minuscule in comparison and all but fell off investors' radar screens. And as demand for dividends faded, companies cut payments and opted instead for more tax-efficient substitutes like stock buybacks.

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Flash forward to the present. The speculative stocks of yesterday are now burned-out hulks. And the once-dowdy dividend is gaining new appeal for investors who have watched dividend-free stalwarts like Cisco Systems go down in flames.

"Dividends are now of greater interest to investors -- share prices have gone up and down dramatically, but dividends stay fairly steady, and provide some cash income during the bear market," says John Carey, portfolio manager of the \$800 million Pioneer Equity Income Fund.

Mr. Carey has a point: The stock market has had a dramatic couple of years, but it remains essentially unchanged. The Dow industrials are off about 4% in the last two years. Since the end of last year, equity-income funds have edged up an average of 0.8%, while broader S&P 500 funds have declined 3.7% and equity funds overall have dropped 1.8%, according to Lipper.

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The Press

A big worry is that any economic upturn will be weak. Despite hints of an economy on the mend, profits are anemic and corporate outlooks are still murky. Through last week, 178 S&P 500 companies and over half of the Dow industrials had reported earnings for the most recent quarter. Investors seemed uninspired by the results: For the week, the Dow industrials ended up just 0.6%, while the S&P 500 index edged up 1.3%.

Such meager performance makes dividends more dear.

"If we're looking at 5% to 7% stock-market returns, that 2% you're getting through dividends becomes an important piece of the overall return," says Tom Huber, manager of T. Rowe Price's \$700 million Dividend Growth Fund.

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The Press



Meet the Elite -- Cover Story

By Vito J. Racanelli

Best Buy, the consumer electronics whiz, tops our fourth annual ranking of the biggest U.S. firms, thanks to the company's muscular stock and strong cash returns on investment. Runners up include AdvancePCS, Performance Food Group, AutoZone and Kellogg.

April 22, 2002

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The Press



The 2002 ranking, our fourth, employs a universe of the top 500 U.S. firms in sales. (As in the major leagues, Canada is represented, as well.) The number-crunching was done by CSFB HOLT, formerly HOLT Value Associates, a Chicago-based consultant to institutional investors and corporate managements, which was acquired early this year by Credit Suisse First Boston. Central to our ranking was HOLT's proprietary metric: cash flow return on investment. CFROI measures the real cash returns on all capital -- debt and equity -- invested in a company, stripped of the effects of inflation and accounting practices, which, as has become apparent in the past year, could distort conventional earnings.

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Barron's used four criteria: stock-market performance, relative to the Standard & Poor's 500, for the 12 months ended March 31; the median CFROI for the latest three fiscal years available, to determine the returns they were generating; the forecast CFROI growth for the current year, and revenue change for the past year, to judge if the company was increasing returns and the top line. (For financial firms, real return on equity substituted for CFROI, owing to the different nature of their assets. We also culled bankrupt firms such as Enron.)

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How did last year's best and worst fare? Well, the shares of the top five in 2001 have outpaced the S&P 500 since publication of last year's list, a few by a considerable amount. For example, last year's No. 1, Quest Diagnostics, the country's largest medical-testing outfit, rose a blistering 68%. The only other company in the top 10 two years in a row, Quest finished a solid No. 9 in 2002.

What about 1999 and 2000 performance? If this is 4th year!

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The Press



Don't ignore the bottom of the list, either, for sometimes, turnarounds lurk. Shares of Great Atlantic & Pacific Tea Co., last in 2001, have soared 200%, thanks to the company's restructuring. This year, A&P is 254th.

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The Press

April 2002—What mattered one randomly selected week



The Jack Welch era is history. Suddenly, running GE is a whole new ball game

April 29, 2002



FCC Chairman Michael Powell is the overlord of industries with \$1 trillion in annual sales, from cable to wireless to TV, radio and the Internet. He vows to revive them by taming Washington's worst bureaucracy.

April 29, 2002



After a stock market slide, a vertical drop in corporate profits, multiple corporate bankruptcies, and even 9/11, there's still reason to be positive.

April 29, 2002

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The Press

"The Business Week 50" 2002



The downturn clipped the wings of many onetime highfliers, making this year's class of top performers a far more diverse group. They may not boast the superhot growth of former tech stars, but they demonstrate something more rare: An ability to prosper in both good times and bad.

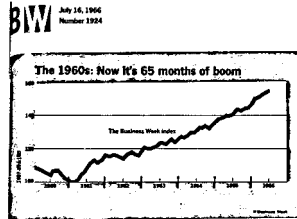
March 25, 2002

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Climbing the Wall of Worry

The Cliff of Complacency

1966-1980—The New “New Era”



Soaring—and then some

Decades began with some boom, but it's now plain
 at U.S. capitalism has learned a lot about
 it—and the economic policies that nourish it

U.S. is now in the 65th month
 of boom because expansion that's
 been exceptional by the rate of
 20% a year (or more) has been
 going on since the end of World
 War II. It's a record that's
 exceeded by the world's most ad-
 vanced economies in just half a
 century, and that's a record that's
 been broken by the U.S. since
 1960.

Business Week
 July 16, 1966

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Climbing the Wall of Worry

The Cliff of Complacency

1966-1980—The New “New Era”
 DJIA Down 27%

BW November 2, 1968
 Number 2044

The boom that just won't stop

With election imminent, indicators show that private economy
 has a lot of momentum left—if plans are carried through

Third-quarter profits, at another record high, make the same
 point despite something of a squeeze on margins (page 30)

Surplus swings federal budget faster than expected (page 32),
 but job of applying restraint now seems up to Fed (page 33)

As the U.S. moves into an election
 year, the economy is showing
 signs of a slowdown. But
 the U.S. economy is showing
 signs of a slowdown. But
 the U.S. economy is showing
 signs of a slowdown. But

How people are betting
 on future business

Of 10 key indicators
 7 point up...
 Average workweek in manufacturing
 New business orders
 New orders for durable goods
 Housing starts
 Money income
 Stock prices

3 point down slightly
 from a high level
 Layoff rate
 Money rate
 Construction contracts

How business
 is doing now

Of 16 indicators

Business Week
 November 2, 1968

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The Cliff of Complacency

March 2000: The "New" New Economy

THE WALL STREET JOURNAL

December 17, 1998

Amazon.com Stock Price
Jumps -- What Else Is New?

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The Cliff of Complacency

***March 2000: The "New" New Economy
Nasdaq falls 70%***

THE WALL STREET JOURNAL

April 1, 1999

Big Idea Turns Priceline's
Founder Into a Billionaire

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Climbing the Wall

1930s: Terror and Opportunity

THE LITERARY DIGEST
JULY 9, 1932

The Chicago Bank Failures

"LADIES AND GENTLEMEN," he began, addressing a nervous crowd of depositors. "my name is Traylor, the chief executive of this bank at this time. Naturally, I am delighted to see so many of our customers here, but I am really sorry that they are afraid of me."

But if those Chicagoans had been afraid, their fears were quickly allayed when Melvin A. Traylor, president of the First National Bank and the First Union Trust and Savings Bank, finished his speech.

As he said, in view of the fact that the bank had lost to thirty-nine

Climbing the Wall of Worry

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1930s: Terror and Opportunity

DJIA Up 372%

The New York Times

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NEW YORK, FRIDAY, OCTOBER 25, 1929.

**WORST STOCK CRASH STEMMED BY BANKS;
12,894,650-SHARE DAY SWAMPS MARKET;
LEADERS CONFER, FIND CONDITIONS SOUND**

New York Times
October 25, 1929

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The Bull Market of the Fearful Fifties

IS THE MARKET RIGHT?

WHILE BUSINESS BOOMS, WALL STREET SLUMPS • IS THE MARKET NOW A SOUP
BUSINESS INDEX? A REVIEW OF THE STREET'S NEWEST PERPLEXITIES

back in January when the great climax of
of Treasury Church, the timepiece of Wall
Street, temporarily ceased to function, many
members of the financial community found
the symbol particularly apt. If Wall Street's
has had not stopped entirely, it could cer-
tainly be said that it has come to a
halt. The financial world has been
shaken to its foundations.



judgment against the underwriters con-
cerns legislation of the business to meet
them. And there was the crowd and cy-
bernetic market, whose stock
market at 5, and, as of our going to per-
haps reached 8. The question about the
great days of the Street's golden era has
become largely a matter of memory, that
by its older shareholders, concessionaires,
and those traders who still
in memory of the Coolidge era as an
era above the recollection of any of
any other era of Princeton or New York.
But Wall Street's golden
era is not a thing of the past.

Fortune
March 1948

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The Bull Market of the Fearful Fifties DJIA Up 405%

A High, But Few Cheers

Stock indexes reach a peak for this year.

But Streeters remain cautious in predictions.

ON MONDAY, the stock market resolutely stopped the backing and filling of recent weeks. Standard & Poor's daily indexes of industrial and utility prices moved to their highest levels of the year (chart).

At midweek, though, the breakthrough had aroused nowhere near the expected enthusiasm among brokers, or among traders and investors generally. Few analysts seized Monday's news to speed "buy, buy, buy" advice to their clients. A...

—since mid-February—to recover 61% of all the ground lost since the bull peak of the 1956 market. And as one market pro points out, "a recovery of such proportions alone would justify a pause for consolidation or technical correction," especially since there has been no such pause before in the post-February rally.

It must also be remembered that since February the market has pushed back into the much advertised "zone of resistance" which it had repeatedly failed to pierce in earlier upthrusts. It's a moot point whether this resistance zone will prove as impenetrable as ever, but in recent weeks the market has markedly lost momentum as it has pushed closer to the zone.

Cap in Yield—Bullish enthusiasm doused with cold water from the sharp narrowing of new yields available on non stocks.

Business Week
May 1957

E. Kerschner

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1981: Inflation to Accelerate Indefinitely?

BusinessWeek

THE DEATH OF EQUITIES

How inflation
is destroying the
stock market

Page 54

Business Week
August 13, 1979

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1984: Depressed by Deficit, Debt, Dollar

The Washington Post

**U.S. Firms Struggle
Under Strong Dollar**

Washington Post
November 18, 1984
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1984: Depressed by Deficit, Debt, Dollar

THE WALL STREET JOURNAL

**Rapid Climb in Debt Casts
Doubt on Growth Outlook**

By ALAN MURRAY
Staff Reporter of THE WALL STREET JOURNAL
WASHINGTON—The federal debt will surpass \$2 trillion in fiscal 1986, giving President Reagan the dubious distinction of having presided over a doubling of the nation's debt burden.
That extraordinarily rapid rise in debt, which will occur even if the president succeeds in winning the drastic budget cuts he proposes, casts doubt upon the economic assumptions that underlie the budget.
The R... "resents an un... "mic

grow weary of economists' warnings about the dangers of budget deficits. But even administration economists concede those dangers are much greater over the next few years than they have been in the past two. The strong stimulus to the economy from deficit spending can provide a big boost in the early years of an economic expansion, when unemployment is high and factories are under-utilized. But as the expansion matures, huge deficits are more likely to cause either inflation, or—countered by tight monetary policy—rising interest rates.
"Deficits that are 3% or 4% of the gross national product when the economy is

Wall Street Journal
February 4, 1985
E. Kerschner

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Climbing the Wall

**1984: Depressed by Deficit, Debt, Dollar
Stocks Up 47% in Two Years**

THE WALL STREET JOURNAL

Rapid Climb in Debt Casts Doubt on Growth Outlook

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The R... rises an
up

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Wall Street Journal
February 4, 1985
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Climbing the Wall

1990: The Saddam Hussein Market

BusinessWeek

**Business Economists
Predict Gloom
-And They're the Optimists**

Business Week
October 8, 1990
E. Kerschner

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**1990: The Saddam Hussein Market
Stocks Rise 34% in 14 Months**

The New York Times

September 18, 1990

Oil Prices Climb on War Fears

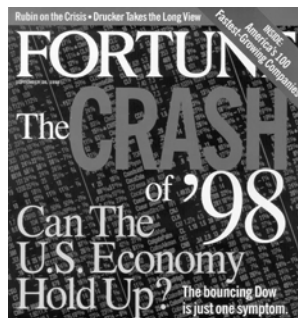
\$1.87-a-Barrel Jump, to \$33.63,
Breaks 7-Year-Old Record

New York Times
September 18, 1990
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Climbing the Wall

1998: Deflationary Danger



Fortune Magazine
September 28, 1998
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Climbing the Wall of Worry

Climbing the Wall

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