The Individual Investor

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Lesson 10
Edward M. Kerschner

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

Dow Jones Industrials Average
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.

End of first Big Shift

(17 year flat market, 1966 – 1983)
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.


- **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 rigueur.

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The second “Big Shift”
*The 1990s*

_Dow Jones Industrials Average_
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

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.”
The second “Big Shift”

The Savings rate . . . Higher than you think?

The Individual Investor and . . .

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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.

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.
The Individual Investor and . . .

*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*

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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 toflashier 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.

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.
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.

Meet the Elite -- Cover Story

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.
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.

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.)
The Individual Investor and . . .

The Press

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!

E. Kerschner

The Individual Investor and . . .

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.

E. Kerschner
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

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

April 29, 2002

The Individual Investor and . . .

The Press

April 2002—What mattered one randomly selected week

“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

E. Kerschner
Climbing the Wall of Worry

And Falling Off the Cliff of Complacency

The “New” Era of the 1920s
DJIA Down 89%
Climbing the Wall of Worry

The Cliff of Complacency


Climbing the Wall of Worry

The Cliff of Complacency


DJIA Down 27%

Business Week
July 16, 1966
E. Kerschner

Business Week
November 2, 1968
E. Kerschner
Climbing the Wall of Worry

The Cliff of Complacency

March 2000: The “New” New Economy

Nasdaq falls 70%

Big Idea Turns Priceline's Founder Into a Billionaire
Climbing the Wall of Worry

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 Taylor, 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 Chicanos had been afraid, their fears were quickly allayed when Melvin A. Taylor, president of the First National Bank and the First Union Trust and Savings Bank, spoke..."
Climbing the Wall of Worry
Climbing the Wall

1930s: Terror and Opportunity
DJIA Up 372%

The New York Times
October 25, 1929
E. Kerschner

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The Bull Market of the Fearful Fifties

Fortune
March 1948
E. Kerschner
Climbing the Wall of Worry

The Bull Market of the Fearful Fifties

DJIA Up 405%

A High, But Few Cheers

Stock indices reach a peak for this year.
But Strikers remain cautious in predictions.

On the surface, the stock market seems to have conquered the batting and bowling component of the Dow. But the upward trajectory of the Dow has been a perfect storm of improved corporate profits, and the market's ability to ignore external factors. As a result, the market has reached new heights, but there are doubts about its sustainability.

By E. Kerschner

Climbing the Wall

1981: Inflation to Accelerate Indefinitely?

By E. Kerschner

Climbing the Wall

THE DEATH OF EQUITIES

How inflation is destroying the stock market

By E. Kerschner
Climbing the Wall of Worry

1981: Inflation to Accelerate Indefinitely?

“Using monetary and fiscal policies to produce a very sharp and immediate reduction in the growth of nominal GNP in the hope of reducing inflation quickly by a large amount would almost surely fail.”

E. Kerschner

Economic Report of the President 1980

1981: Inflation to Accelerate Indefinitely?

Stocks +43% in two years ended Sept. 1983

+1261% in two decades

Barron’s

Go for Broke?
The Long-Term Bond Market May Not Survive

EDITORIAL COMMENTARY

Barron’s
November 3, 1980

E. Kerschner
Climbing the Wall of Worry

1984: Depressed by Deficit, Debt, Dollar

U.S. Firms Struggle Under Strong Dollar

Washington Post
November 18, 1984

The Wall Street Journal
February 4, 1985
Climbing the Wall of Worry

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

By Anne Womack

WILLIAMSBURG, Va., March 5—The leaders of the United States and the Soviet Union, meeting here to talk about the future of the world, were wrestling with problems that stretch back to the dawn of their countries.

The Chinese and the Japanese, with their growing economies, were finding it difficult to match the rapid growth of their neighbors. The Chinese and the Japanese were finding it difficult to match the rapid growth of their neighbors.

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Climbing the Wall

1990: The Saddam Hussein Market

Business Economists Predict Gloom -And They're the Optimists
Climbing the Wall of Worry
Climbing the Wall

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

Climbing the Wall of Worry
Climbing the Wall

1998: Deflationary Danger

Fortune Magazine
September 28, 1998
Climbing the Wall of Worry

1998: Deflationary Danger
Stocks Soar 33% in Two Months

Climbing the Wall


Climbing the Wall
Climbing the Wall of Worry
*Climbing the Wall*


2001: Terrorist Attack
Stocks +27% 9/21/01-12/31/03