



Don't Just Watch the Parade Go By

By Arne Alsin

11/9/2009 11:30 AM EST

URL: <http://www.thestreet.com/p/rmoney/investing/10623575.html>

Count on it. For the next several years, the stock market belongs to the bulls. You're going to see periodic pullbacks, to be sure, but they'll be minor, transitory affairs, just enough to keep sideline money out of the market for as long as possible.

As in every bull market in the modern era, the average investor will miss much of the harvest to be had in this cycle. They've certainly been on the sidelines for the initial move: For the first nine months of 2009, investors pulled \$8 billion more out of stock funds than they put in. And in the face of the best year in stocks since 2003, the data show that in early October the net redemption rate actually accelerated, with a net \$5 billion redeemed.

Investor aversion to stocks is beyond bewildering, especially when stocks are compared with alternative investments. Ticc sized yields on cash barely beat the nonexistent yield generated from under-the-mattress investing. In the aftermath of the 1982 bear market and the 1987 crash, at least investors could hide out in cash and collect 9% and 7% yields, respectively. Now, fearful investors get slapped two different ways: They get to watch a major bull market march resolutely higher, and they get paid next to nothing while they watch.

Treasury bonds are even worse than cash because of the inordinate principal risk that owners of Treasuries have to absorb. Paltry yields of 3% and 4% for long-term Treasuries aren't high enough to compensate owners for the risk of inflation. Rates only have to go up modestly for the decline in value of long-term Treasuries to reach double-digits.

It's the stuff of a big bull market in stocks: The crowd simply doesn't see it until after the fact.

To capture the upside that's coming, you've got to recognize the opportunity. You can do it by taking a step back and looking at the big picture. Start with this: 200 years of history that says big bull markets always follow big bear markets. Check your charts, if you must, but you'll not find a single exception to this rule.

Logically, big rebounds necessarily follow big declines. That's because the value of a business equals the net present value of its future free cash flow. The "future" does not end next quarter or next year. By definition, value is a long-term proposition. Short-term, emotion-laced selling can cause huge declines in price, but it's always temporary. As rationality returns to the marketplace, so does price, back toward the net present value of future free cash flows.

Another way to see opportunity is to piggyback on the minds of smart investors. Early in a bull cycle, when the spread between price and value is wide, you see the shrewdest investors loading up on stocks. It should come as no surprise that Warren Buffett has been investing at his most aggressive clip in 35 years. Not only has he invested in well-known names such as **General Electric** (GE) and **Goldman Sachs** (GS), among others, he recently made his biggest purchase ever in acquiring **Burlington Northern** (BNI).

The significance of Buffett's latest move is difficult to overstate. He gets the big themes right: building up cash earlier this decade, his call on Internet stocks in the late '90s, his repeated warnings about derivatives and his bullishness following the 1974 and 1982 bear markets. Because of Burlington Northern high fixed-cost structure and sensitivity to the economy, Buffett's purchase is a quasi-leveraged bet that a return of economic growth is around the corner.

Are the ingredients in place for a long bull market?

Probably the most exciting dynamic in this bull market is the off-the-charts pessimism that permeates the thinking of virtually all market participants, from investors who refuse to invest, to CEOs who have hoarded record amounts of cash (11% of corporate assets are now in cash, up from 4% in the early '90s), to the majority of market pundits who view the future with fear and trepidation. Implicit in the pervasive pessimism is that this bull has years to run, because it will take that long for complacency and enthusiasm to return and gain traction.

Historical data also support the notion that this bull is a babe, with years of ample returns to come. After every incremental 10-year period when the **S&P 500** has lost ground -- the market is down about 25% for the last 10 years -- the ensuing 10 years see the S&P compound at 10% or more.

And if the data are not enough to fire up your enthusiasm for stocks, there's always the big picture. In the annals of economic history, there has never been a stage set for worldwide growth quite like the current era. We're in the midst of two historic, ongoing revolutions, the likes of which will never be repeated: the opening up of the world for business, and the massive changes wrought by technological advances. Alone, either one of these paradigm-changers would augur well for stocks over the next decade. Together, the potential for wealth-building in the years to come is on a scale that should take your breath away.

At the time of publication, Alsin was long GE and GS.

Arne Alsin is the founder and principal of Alsin Capital Management, a California-based investment adviser. Under no circumstances does the information in this column represent a recommendation to buy or sell stocks.
