



How to Trounce the Market

By Arne Alsin

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I'll give you the answer in advance: Duh!

Before I pose the question, however, let me say that within it lies the key to outperforming the **S&P 500** -- and not just by a percentage point or two -- I'm talking about trouncing the broader index by as much as a factor of two or three.

First, let me just say that, normally, beating the market by 2%-3% on an annual basis is considered impressive. But this isn't a normal bull cycle. It's as much an outlier, as aberrant as the preceding bear market, which ravaged stocks and inflicted grossly disproportionate price damage. But it took that kind of beating to set investors up for a chance to run circles around the S&P right now.

If we search for a historical precedent, we would have to look back to the comparatively savage 1973-74 bear market and the bull cycle that followed, when value-centric money managers such as Bill Ruane of the Sequoia Fund, Rick Guerin, and Walter Schloss, among others, crushed the S&P for four years straight, beginning in 1975. Ruane, for example, beat the S&P by an average of 30 percentage points a year. The key then is the same as now. And it's implicit in this question:

In the current market cycle, which would give you a better chance of scoring a multi-bagger: A stock trading at \$40 a couple of years ago that is now at \$10, or a \$40 stock from a couple of years ago that still trades at \$40?

If you're paying attention to the market at all, you know the answer: It's much more likely for a crushed stock trading at \$10 to rebound to \$30, than it is for a stock that has steadily traded at \$40 all along to soar to \$120.

Call it what you will -- a retracement, rebound, or recovery play -- it's the secret behind the 104% annual return that the members of my Top 10 for 2009 generated, a return that easily beat the S&P's 28% yield. When the list was compiled, the picks were trading at 25 cents on the dollar relative to their pre-bear levels. In the ensuing rebound, five out of 10 more than doubled, and three of those returned more than 200%.

Why is the rebound play the ideal strategy? Here are a couple reasons:

Rebound stocks are plentiful: Because the mega-bear claimed so many victims, investors have lots to choose from. Sift through the mess, and you find industry leaders, companies with bullet-proof balance sheets, as well as ideas in virtually every industry group. My Top 10 for 2010, for example, includes everything from consumer-product growth stocks such as **Smart Balance** (SMBL), to technology stocks **NCR** (NCR) and **MEMC Electronic Materials** (WFR), to global infrastructure plays such as **Manitowoc** (MTW) and **KHD Humboldt Wedag** (KHD).

Indiscriminate market damage: The mega-bear mauled strong companies along with the weak. This is what makes stock selection in this cycle easier -- and inordinately profitable. In normal times, stocks fall for a reason, such as missed earnings or accounting irregularities, or unexpected and sudden product obsolescence. You can make money buying such stocks, but it's risky, and big returns usually take years to realize. But there was nothing wrong with many of the companies that got clobbered by the bear in 2008. **CarMax** (KMX), **Expedia** (EXPE), **Raymond James** (RJF), to name a few from my Top 10 for 2009 -- yet their stocks cratered due to a liquidity panic and the unwarranted fear that economic catastrophe was around the corner.

What do such stocks require to multiply and prosper? Surprisingly, not much. They don't need to develop a world-altering new product or create a paradigm shift. To score a multi-bagger in a normal

cycle, you've got to unearth the next big thing, the next **Google** (GOOG) or **Amazon** (AMZN). To score big in this cycle, you simply load up on stocks that are set to retrace their bear-market price declines.

Need some ideas on where to look? Check out my Top 10 for 2010, five of which I've already named above. When the list was compiled in December, the stocks were trading at 29 cents on the dollar relative to their pre-bear levels. Even if they only climb back to 60 cents on the dollar, on average, that would be a three-digit rate of return.

Would that help heal your bear-market wounds?

You don't have to say it. I already know the answer.

At time of publication, Alsin and/or ACM was long RJF, KMX, EXPE, NCR, KHD, WFR, MTW and SMBL, although holdings can change at any time.

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. Alsin appreciates your feedback; [click here](#) to send him an email.
