



## Nothing Can Hold a Candle to Stocks

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If you're involved in the stock market long enough, you're going to get it wrong eventually. Consider it a *fait accompli*: Sooner or later, you're going to get slammed.

While I didn't own single financial stock going into the crisis of 2008, I suffered nonetheless because the financial meltdown led to a liquidity crisis, which led in turn to disproportionate damage to smaller stocks, of which I owned plenty. When you get pasted by the market, it's important to stay grounded and to focus anew on your core strategies and beliefs. If they're conceptually sound, embrace them with vigor. Rather than abruptly changing styles, it's always better to stick with what you know; it'll give you the best chance to recover from a bad run.

Along those lines, here are some of my core beliefs and concepts, all of which I spent a good deal of time thinking about after a tough 2008.

### **Analyze Publicly Traded Businesses as You Would a Private Business**

The analytical nexus around which investing revolves begins and ends with value. Private businesses infrequently change ownership, but when they do it entails a lengthy evaluation period with a carefully calculated valuation analysis. Apply the same analytical approach to publicly traded businesses, and it makes buy and sell decisions easy. If you know that the business of **Starbucks** (SBUX) is worth [\\$25 a share](#), it's a no-brainer to buy when it's trading at \$10 and to run for the hills if the market prices the stock at \$60.

Surprisingly enough, it's much easier to value a publicly traded business than a private business, because publicly owned businesses tend to be more stable and their data set is almost always more substantial.

On the other hand, it's much easier to "own" a private business than a publicly traded business. A private business owner rarely gets a takeout offer and he can laugh off an occasional pennies-on-the-dollar offer. An owner of stocks is constantly deluged with buy offers that are often below fair value. All it takes is one weak moment, one moment of doubt, and the shareowner ends up giving away an asset at a fraction of its worth.

### **Businesses Are the Best Asset to Own**

Despite suffering a decline in the stock market in 2008, my faith in owning shares of businesses is unshakable. Nothing comes close in performance over the long term, with stocks outperforming every other asset class by a factor of two or more. And after a decade of underperformance relative to other assets, stocks are *the* asset to own for the coming decade.

If you understand why stocks outperform, you'll never look at them the same way again. A business is the only asset that is both self-perpetuating and value-creating. Over the next five years, with modest earnings gains, companies like **Costco** (COST) , **Wal-Mart** (WMT) and **McDonald's** (MCD) will generate cumulative cash earnings equal to about 50% of their current stock market value. Shareholders reap the benefit of this 50% earnings yield in two ways: Part of it is issued in the form of dividends and the remainder is invested by

management. Who wouldn't want part of their yield allocated by someone as talented as the CEO of Costco, Jim Sinegal?

Other investments don't hold a candle to stocks. Yields in the fixed-income market are paltry, and bonds are long overdue for an extended period of underperformance. In contrast to the self-perpetuating, value-creating characteristics of stocks, commodities are static, speculative investments. While some of the commodities are essential for a functioning society -- like grains and oil -- other commodities, such as gold, are pure speculations, with prospective returns wholly dependent on the "greater fool" theory that someone will come along tomorrow and offer more money for exactly the same asset.

### **Understanding of Risk Is Your Best Protection**

While an accurate calculation of value is the key to successful investing, it's the spread between value and price that's the linchpin of risk management; the more that value exceeds price, the lower your risk. Last [December](#), when **CarMax** (KMX) stock was trading at \$7.44, I said it was worth \$20 a share and I made it one of my top 10 recommendations for 2009. The gulf between price and value made it a low-risk investment.

Shortly after my recommendation, though, CarMax dropped \$2 a share, or 27%. But the price drop actually *lowered* the risk of holding the stock. That's because the spread between price (\$5.44) and value (\$20) had widened considerably. Today, with the stock trading at \$20 a share, owners are happier because of the increase in price. But their happiness should be mitigated by a change in risk. The risk of owning this asset is much higher because there is no longer a gap between price and value.

### **Top 10 List for 2010 On Its Way**

My top 10 list for 2009, published exclusively for *RealMoney* subscribers last December, is currently up 87% vs. the **S&P 500's** gain of 23%. Look for my upcoming top 10 list for 2010, to be posted next month. If you have an idea you'd like me to consider for the upcoming list, send me an email. I'd be happy to take a look, and if value exceeds price by a hefty amount, you just might see it included in my top 10 list for 2010.

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*At time of publication, Alsin and/or ACM had no positions in the stocks mentioned, 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.*

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