



The Stock Sale of the Century

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The hellish bear market that ended Nov. 20 was phony -- at least in part. A sizable chunk of the 52% decline in the **S&P 500** shouldn't have happened. The market should have dropped by 10% to 15% because of the economy and, perhaps, another 10% to 15% for the emotion-based selling that typically accompanies big declines.

Ironically enough, the stock market got smacked more than it deserved because it's damn good at what it does. Other markets were miserable failures, gumming up when they were needed most -- for commercial paper, high-yield bonds, investment-grade bonds, mortgages and CDOs, among others. When other markets became paralyzed, investors who wanted cash turned to a market that stayed open and fully functional: the stock market. There was, of course, one stipulation for sellers of stock: You had to be willing to sell at any price.

Because of the extraordinary damage wrought by liquidity-induced selling, we've just witnessed the worst U.S. stock market in history. Carnage such as the 50% drop in the Russell 2000 in just 45 trading days (ending Nov. 20) has no parallel. Market volatility has been so extreme, it's breathtaking.

The 50-day average change in the S&P 500 reached 4% in November. In years past, a one-day 4% change in the market would be a headline grabber. To average a 4% daily change for several weeks is mind-boggling. The 1932 market got up to a 3.5% average change for 50 days, but all other bear markets are cubs in comparison. Only in 1938 and 1987 did the market volatility get past a 2% average daily change for 50 days.

Don't listen to those who say the 52% loss in the S&P 500 ranks third among bear markets, behind the 1929-1932 and the 1938 bear markets. The 1929 decline started at stratospheric levels, after a skyrocketing 497% eight-year bull market. And, similarly, the 1938 bear started after a 372% six-year bull market. Going into the 2007-2008 mega-bear market, the market was up 63% over the prior six years and even less for the prior eight years.

Although the 1929-1932 low was made below book value, the recent low in the market, at 1.5 times book, is arguably comparable. That's because capital-intensive industries dominated the landscape back then -- American Smelting & Refining, Bethlehem Steel and General Motors -- required an asset-heavy manufacturing base. The bedrock of value in modern companies, like **Pfizer** (PFE), **Microsoft** (MSFT) and **Proctor & Gamble** (PG) rests in their brains and brands -- intangible assets not reflected on balance sheets.

Dreams do come true, even in the investment arena. Although you probably weren't investing during the last sale of the century, in 1932, you're looking squarely at the 21st century's rendition. So consider yourself blessed. There will be many more bear markets in the decades to come, but chances are good that we won't have the same unhappy confluence of variables: economics, emotion and an aberrational liquidity squeeze.

According to some observers, a new bull market commenced Nov. 21 because the S&P has met the technical requirement of a 20% increase. If true, that fits the framework of market rebounds historically. That is, new bull markets typically occur at around the midpoint of a recession. Since the current recession is already one year old, we're at the midpoint if the recession lasts for another year.

How should you be positioned for the new bull market? In general, stocks that suffered the most from liquidity-induced selling will rebound the most. That means, of course, that you'll make the biggest return from smaller, less liquid stocks. It's already the case -- since Nov. 21, small stocks have outperformed big-caps by nearly three-fold.

Note, too, that all companies crushed by 80% or more are not created equal. An 80% drop in a big-cap is more likely to be for cause, while an equivalent decline in a small-cap is more likely due to liquidity pressure. Since dozens of analysts follow the big-caps, they tend to be more efficiently priced than smaller companies, many of which have no analyst coverage.

To help you in your stock selection efforts, look for my upcoming column where I'll list 10 bargains for the new bull market. I expect this list of stocks to generate returns of at least 100% over the next year or two.

At time of publication, Alsin and/or ACM was long Microsoft, although holdings can change at any time.

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