



Stocks On Sale

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Most investors are woefully underinvested in stocks. Many have allocated a tiny fraction of what they should allocate to stocks and some are out of the market entirely, saying it'll be a long, long time before they get back in. Like never.

It's a huge mistake.

But it's also a perfectly understandable mistake. The mega-bear market that ended in March wasn't just the worst decline since the Great Depression. It was the topper, a crushing crescendo to 10 years of abysmal performance. Investors have been slapped around since the market first cracked in 2000 -- to the tune of a 25% loss for the decade if they've been invested in big-cap stocks and 40% or more if they've been invested in **Nasdaq** or small stocks.

It's been an ugly decade, a lost decade for many investors, particularly for those who first started investing in stocks during this period. It's no wonder many investors are skeptical about the ability of the market to deliver returns sufficient to fund their retirement or other long-term needs.

Despite the last 10 years though, it doesn't follow that a skeptical view of the market is warranted. Even jaded investors know that the best time to buy stocks is on the heels of a massive selloff. But "knowing" and "doing" are two different things, and investors have come up with all sorts of excuses to avoid participating in this bull market. Here are a few of the more common refrains.

After the recent rally, the market is no longer cheap.

Unsophisticated investors are prone to falling for this falsehood, primarily because common benchmarks for valuation are misleading in the early stages of a bull market. For example, price-to-earnings ratios are altogether worthless in the current market. In 2003, in the midst of the last cyclical downturn, stocks such as **Caterpillar** (CAT) , **Cummins Engine**, and **Boeing** were dirt cheap, but not if you looked at their P/E ratios, which ranged between 27 to 33. The ratios were high because their earnings were temporarily depressed. The stocks of the three companies went up an average of about 400% into the cycle peak in 2008. And after the meteoric rise in their stocks, their P/E ratios were much lower, at 11, 12, and 18, respectively, because of massive gains in earnings.

By calculating normalized earnings power for companies, investors can see that the vast majority of companies have significant untapped earnings power, power that will be unleashed when the economy improves. Four that I have recommended in recent weeks are **NCR** (NCR) , **Terex** (TEX) , **Manitowoc** (MTW) and **Liz Claiborne** (LIZ) . In each case, achievement of normalized earnings (note this doesn't mean "peak" earnings) implies a stock that is at least double the current quote.

The economy stinks.

It's surprising how many investors consider this a legitimate rationale for avoiding stocks. Every major bull market in history has started when the economy is struggling mightily, usually when it's in the throes of a recession that has no end in sight.

As history shows, the time to be fearful of equities is when the economy has been robust for several years running. During such periods investors are lulled into thinking the good times will keep going. It's when the entire financial system slips into the complacency trap -- banks lend more than they should, underwriting gets sloppy, and companies get overly aggressive in pursuit of expansion.

It's the polar opposite now, with lean-to-the-bone operating structures and corporate coffers flush with cash. Caution is the watchword of the day, and that's one reason why you'll continue to see impressive quarterly earnings reports for at least the next couple of years.

I'll invest in stocks after the economy improves.

This all-too-common excuse for avoiding stocks flies in the face of both history and common sense. Since bull markets always start well before a recession ends investors are saying, in effect, that they'd prefer to wait and pay a premium for stocks. Warren Buffett employs the metaphor of shopping for groceries to expose the irrationality of waiting. Every sane person understands that a gallon of milk selling for \$3.50 today is a better value than the identical gallon of milk that sold for \$4 last week. As Buffett has often lamented, investors discard rational shopping notions when it comes to stocks.

After the economy improves, the normalized earnings power of companies will be revealed for all to see. You won't be able to buy NCR for \$10 a share -- try \$20. You won't be able to buy Terex at \$22, it'll be in the \$40s; or Manitowoc at \$11, look for it in the \$20s; or Liz Claiborne at \$5, it'll be more like \$10 to \$15.

The time to allocate capital to stocks is when stocks are on sale. For many stocks right now, it's a sale of 50% off. And get this shoppers: You don't even need to clip a coupon.

At time of publication, Alsin and/or ACM was long NCR, Terex, Manitowoc, Boeing and Liz Claiborne, 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.
