



Ten Reasons to Stay Bullish – Part One

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Believe it: We're in the midst of a bull cycle that has years -- not months -- to go before it's over. You're either on board with this bull or you're not. And if you're not, you're setting yourself up for some major frustration down the road. Back in the 1980s and '90s, you could miss bull moves and still make 6%-9% per year in money market funds and more than 10% annually in bonds.

That's not the case now. In this cycle, you've got only one play if you want to generate a healthy return, and that's to invest in stocks. If you're in cash or bonds, you're going to lose. Period. Ask your local banker what the current yield is on a CD, then do your best John McEnroe imitation: "You cannot be serious!" Net of taxes and inflation, the minuscule yield you get from cash is a certain money-loser.

After a decade of outperformance, bonds have already started a lengthy retracement phase. Bonds lose value as interest rates climb, and today's paltry yields have started marching higher. How could it be otherwise? An avalanche of liquidity has been dumped into the system as the **Fed** and Treasury intervened in the market to keep long-term rates artificially low. Bully for the economy, but it will not do anything for long-term bondholders. My recommendation: Your allocation to bonds should be a big, fat zero.

By the way, don't listen to pundits who say bull markets in stocks don't occur when interest rates climb, or when inflation perks up. They're wrong. Check out the late '60s, or even better, the post-1974 bull market, which most closely resembles the current cycle.

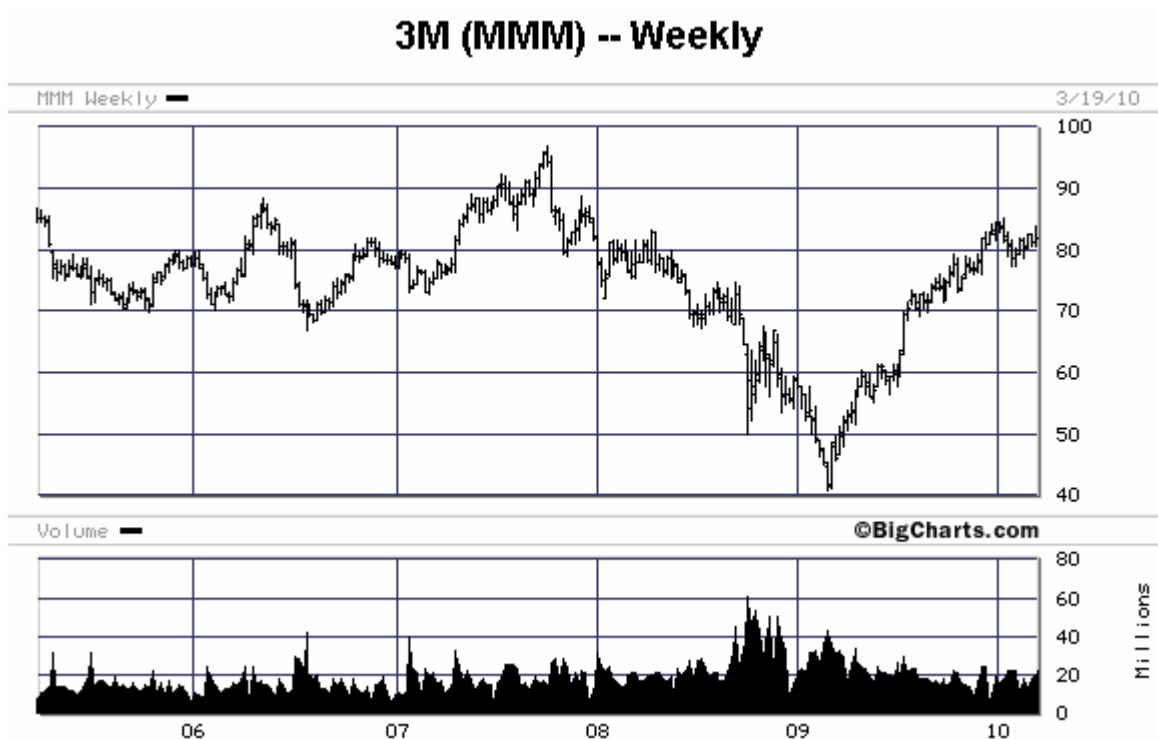
The sooner you understand that the stock market is the only game in town, the sooner you can get started making some money. To help buttress your confidence in stocks, I'll give you 10 reasons to be bullish for the next three to five years. In this, the first of a series on that subject, I'll give you the first three reasons.

No. 1: Stocks are undervalued.

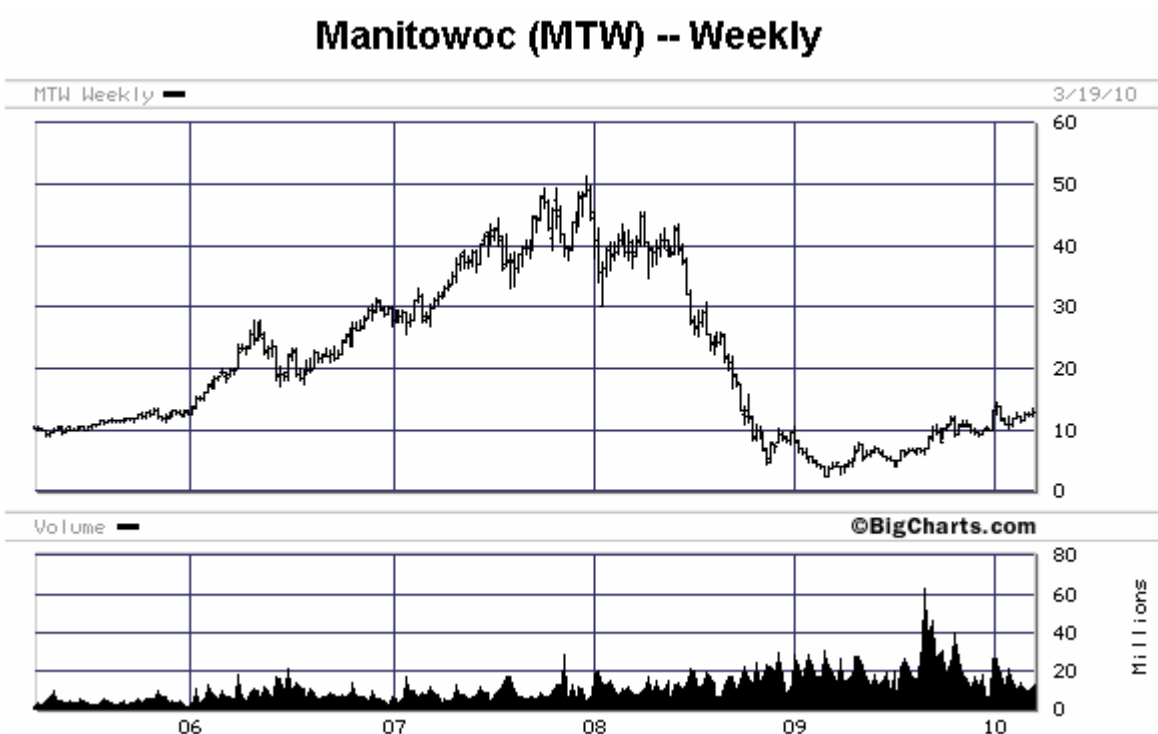
When I look at the bargains to be had in this market, I can't help but do cartwheels. I've never seen a cycle like this one before and probably never will again. What's most amazing is that the widest gaps between price and value are almost exclusively in smaller names -- not in big-cap stocks. That's why it's easy to generate returns that are two to three times the **S&P 500**, which is dominated by the big-caps.

Believe it or not, the indices may get easier to beat from here on out. That's because many of the biggies have already fully recovered to pre-bear-market levels. Look at the five-year charts of stocks like **3M** (MMM) , **Hewlett-Packard** (HPQ) , **Cisco** (CSCO) and other big-caps that got cut in half during the bear market. They've already made a full retracement.

Here's 3M's five-year chart, for example:



While the big-caps have largely rebounded to pre-bear-market levels, the recovery of many smaller stocks is just getting started. Here's an example: **Manitowoc (MTW)**, one my top 10 picks for 2010, is early in its retracement phase. You don't have to be a math wizard to figure out that a recovery to one-half of its old highs represents a hefty return (about 100%), a return that the indices will be hard-pressed to match.



Another stock worth buying that's similar to Manitowoc is **Terex (TEX)**, currently trading at \$22, down from over \$90 before the bear market. In the case of both Manitowoc and Terex, the companies have dramatically improved their balance sheets and their management teams are laser-focused on operating efficiency. Ironically enough, the long-term thesis behind these stocks is the same today as it was in 2007 - the infrastructure build-out in the world's emerging economies is a powerful trend that will last for decades.

For more ideas of stocks to buy -- specifically, stocks that are in the early stages of recovering to pre-bear-market levels -- see my latest update on my Top 10 List for 2010. While I continue to recommend all 10 picks on the 2010's list, you'll find three more ideas from my latest 2009 list update as well.

No. 2: Cheap best-in-class plays abound.

As a value-centric investor in the tradition of Benjamin Graham and David Dodd, the single most surprising aspect of this bull cycle is this: I don't have to reach. In other cycles, I troll for bargains among companies beset by issues and problems. That's because, normally, they're the only companies selling at significant discounts. Companies operating at maximum efficiency just don't sell at bargain prices in a normal cycle.

That's what makes this cycle a beauty to behold: Bargains are plentiful among companies that haven't made an operational misstep. Many stocks were crushed during the bear market solely due to worries about the economy -- a cyclical variable that's external to operations. We can debate the precise timing of the recovery, but this much is certain: The economy will recover.

I've recommended numerous best-in-class companies in recent columns -- companies that don't have issues, that don't have problems to fix. Here are a few you should consider buying: **USG** (USG), **Mueller Water** (MWA), **Brink's** (BCO), **Leucadia** (LUK), **Huntsman** (HUN) and **NCR** (NCR). Their stocks are discounted principally because of the economy -- sooner or later, it's going to improve.

No. 3: Complacency and exuberance are nowhere in sight.

The psyche of investors has been scarred after a punishing decade-long cycle that started with the bursting of the technology bubble and ended with the worst bear market in 80 years. In light of such a difficult decade, it should come as no surprise that the average investor was a net seller of stock funds in 2009, even though it was a terrific year for stocks. It's going to take years to rebuild investor confidence, before enthusiasm and complacency make their inevitable return to stocks.

If we look to historical precedent -- to what followed the mega-bear markets that ended in 1932 and 1974 -- it is reasonable to expect a long-lasting bull cycle of five to six years. History clearly shows, too, that there is symmetry between bear markets and the bull cycles that follow. Baby bear phases beget baby bulls, and big, bad bear markets are followed by robust bull markets.

Look for the rest of this series, in which I'll give you seven more reasons to be bullish on stocks. Pay particular attention to the very last of the 10 reasons, by the way, to be revealed at the end of Part 3 -- they include the overarching rationale for being bullish, and it's vitally important to you, as an investor.