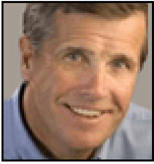

10 Reasons to Stay Bullish -- Part 2

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Investors are scared of stocks. On the heels of a terrible decade -- a decade that culminated in the worst bear market in 80 years -- it's no wonder investors are afraid of the market.

Don't count me among the fearful. I'm literally doing cartwheels over the money to be made in this bull cycle. While it's difficult to find undervalued names among big-cap stocks, it's easy to find bargains among smaller stocks. And that, in turn, makes it a snap to beat indices, such as the Dow Average and the S&P 500, that are heavily skewed toward big-caps stocks.

In an effort to bolster the confidence of skittish investors, I'm giving you 10 reasons why you should count yourself among the ranks of the bulls. In this, the second installment of a three-part series, I'll add three more reasons to those I detailed in Part 1.

No. 4: The best investment always has been and always will be ... stocks

In just 90 years, if the market performs as it did last century, the **Dow** will exceed 2,000,000. It's highly likely this threshold will be exceeded because of one thing -- profit. Each and every day, with nary an exception, wonderful companies like **Coca-Cola** (KO), **Wal-Mart** (WMT), **IBM** (IBM), **Johnson & Johnson** (JNJ) and **Proctor & Gamble** (PG) make money. Those cash profits are either returned to shareholders via dividends and stock buybacks, or they are reinvested in the company to facilitate making even more profit.

It's the accumulation and compounding of profit that makes stocks such a stellar investment. It's why stocks outperform every other asset class by at least 2:1 over the long term. Buy a 10-year bond today, and you'll get the same 3.85% yield 10 years from now. That's not the case with most businesses. Proctor & Gamble's annual earnings, for example, have grown steadily from $1.56 per share a decade ago to $2.53 five years ago to $3.60 this year. And its earnings will continue to grow, as the cash profits not returned to shareholders (P&G sports a 2.7% yield) are reinvested, resulting in an ever-growing asset base.

When Warren Buffett began buying Coca-Cola back in 1988, it was selling at about 15x earnings, for an earnings yield of 6.5%. At the time, the 10-year Treasury yielded 9%, which most observers (except Buffett, of course) would have said was very attractive compared with Coke's earnings yield. But Buffett keyed in on something besides the PE ratio and earnings yield. He saw that the cash earnings retained by the company consistently compounded at an average of 25-30% per year. Over time, then, the asset base would compound and grow in a big way. In the 20 years since his investment, earnings, net assets and, most importantly, the stock price are all up ten-fold.

While there are more undervalued companies in the Dow Average, such as **General Electric** (GE) and **Boeing** (BA), I'd bet that over the next 10 years, investors in the Dow stocks named above -- KO, WMT, IBM, JNJ and PG -- would make at least twice what they'd get from investing in today's 3.85%-yielding 10-year Treasury bond. And it'll be because of the accumulation of profit, compounded at rates of return that are much higher than the 10-year Treasury yield.

No. 5: You should be bullish, because the average investor isn't

The pile of evidence is overwhelming, incontrovertible and, unfortunately, embarrassing. There is no nice way to say it: When it comes to stocks, the average investor just isn't very good. (Note that this doesn't include *RealMoney* subscribers, of course, all of whom, in my clearly unbiased opinion, are far above average).

Flows into and out of stock funds paint a dismal picture. Investors poured record amounts of cash into the market in the three months leading up to the Nasdaq peak in March 2000. Last year was the best year for stocks since the 1930s and investors were net sellers of stock funds.

The average investor, simply put, is notorious for selling low and buying high. To illustrate the point, consider how investors fared in the best-performing stock fund of the decade -- Ken Heebner's CGM Focus Fund, which was up 18.2% annualized. According to Morningstar, the average GGM investor lost 11% annually. How could this happen? Investors bought into the fund after it had huge runs and then, when the fund dropped in value, they panicked and sold.

Ironically enough, while stocks had a great year in 2009, investors poured record amounts of money into bond funds. The takeaway is easy enough to identify: Based on the track record of investors, you should buy stocks. And your allocation to bonds should be, as I said in part one of this column, "a big, fat zero".

No. 6: The world is open for business

The seminal economic event of recent times that historians will point to is the fall of the Berlin Wall in 1989. Since then, the world has opened up for business -- from China to India to Eastern Europe, growth opportunities abound for American companies that didn't exist a generation ago.

Each of the five Dow companies mentioned earlier -- KO, WMT, IBM, JNJ and PG -- have already taken advantage of growth in emerging markets, with the potential for a lot more to come. By itself, this secular tailwind, destined to last for decades, makes these companies materially more valuable.

In particular, the build-out of infrastructure in emerging economies is a theme that is sure to make a lot of money for investors. And while big companies, such as **Caterpillar** (CAT), will grow in value because of it, there is even more upside to found culling through smaller names leveraged to this theme. For example, I've recommended **Terex** (TEX) and **Manitowoc** (MTW) in recent columns, but there's also **Huntsman** (HUN) and **Leucadia** (LUK), a couple of names from my Top 10 list for 2010.

Look for the final installment of this three-part column next week, when I'll give you the final four reasons to be bullish. The capper is the tenth reason. We can engage in a healthy debate about the first nine reasons to be bullish. With all due respect, though, the tenth reason is not up for debate. And it also happens to be the overarching reason to be bullish.

At time of publication, Alsin and/or ACM was long TEX, MTW, HUN, LUK, JNJ and WMT, 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.