



April 2008

The Lost Decade

A pessimist is one who makes difficulties of his opportunities; an optimist is one who makes opportunities of his difficulties – Reginald B. Mansell

It's hard to tune into any media outlet these days without getting an overwhelming sense of melancholy (or downright panic for that matter). I came across an article in the March 26th edition of the Wall Street Journal. The article, entitled *Stocks Tarnished By "Lost Decade"*, bemoans the return (or lack thereof) of the S&P 500 for the last decade. As of April 2nd the S&P 500 closed at 1367.53. At its peak in 1999 it closed at 1362.8. Your eyes don't deceive you, the index is now only 4.73 points above its previous peak. Over the past nine years, this index is up a *total* of .3% not including dividends (the coffee can ain't looking too bad by comparison). Over the past 10 years this same index is up a measly 1.3% per year adjusted for dividends and inflation. I have to admit, this article made me downright giddy.

One of the great concerns I shared with others back in the late 90's was the general level of stock prices relative to the underlying value of the companies that they represented. Back then the average stock was priced at 40 times its profit per share. Today that number stands at 20. The market traditionally trades at around 16. So how did we get from 40 to 20 if the stock market is priced the same as it was 9 years ago? The magic is in the formula of the p/e ratio where p = price and e = earnings. The average p/e ratio back then indicated that the price someone was willing to pay for a stock was, on average, 40 times its earnings per share. Since we know that the numerator (price) has stayed essentially the same for the past nine years, the formula tells us that the denominator of this ratio (corporate earnings) must have doubled during that time for the number to shrink to 20. Now, we are still not down to 16, but we are a darn sight closer to being fairly valued than we have been for awhile.

Take a look at your Access statement. Although the US stock market hasn't done much of anything for the last 9 years, I think you'll find that you have. The reason is simple; we did not place all of your money in the 500 largest companies in the US stock market as your sole investment. We have looked for other stores of value, namely: commodities (oil), international holdings, real estate and bonds and cash to both stabilize your portfolio and to take advantage of markets that have looked reasonably priced.

During the time we were off in search of alternative investments to strengthen your portfolio, the US stock market has continued to get cheaper. I think there is a high probability that it may get even cheaper, but I am far more enthusiastic about the overall US market precisely because it has performed so poorly in the recent past. Before you start sniffing my coffee cup, I do realize that we have some problems that are not going to go away quickly or painlessly. The subprime mess is just that; see my April 2007 newsletter, *Ground Chuck* (available on the website @ www.accessinvestmentadvisors.com in the Clients tab under Access Newsletters in the archive section). Yes, we are in a recession, but that doesn't signal the end of life as we know it. Yes, energy prices are high, and will continue to climb (see my January 2005 article *Why I Love \$3.00 Gas*, and April 2005, *See Through Corn*). I do, however, have confidence in the ingenuity and adaptability of the human spirit. Man (and woman) has a way of coming up with creative solutions, particularly when there is reward for finding them (read: capitalism). Until we and the rest of the world outlaw capitalism, smart people will figure out ways to build a better mousetrap and will be well paid for doing so. Even during a lost decade, investing in the right mousetrap pays dividends.

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