



Bull Market Stew

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Dear Fellow Investors:

Back in March of 2009 we did a presentation titled “Bull Market Stew”. The idea was that you could look back at the circumstances surrounding major US stock market bottoms just prior to huge bull market moves and compare the current circumstance. The neat thing was that much like a chef on the Food Network, you are simply gathering ingredients, preparing them as the recipe dictates and expecting to cook up the finished product. You’d expect the “new” stew to turn out very similar to prior stews. Today’s circumstance is so similar to March of 2009 that we thought we should run through the ingredients we listed back then and give our viewpoint on where they are today:

1. One or more major Bear Market declines in the prior ten years, preferably with a decline of more than 40% and overall poor multi-year stock market performance—True, 2000-2002 Bear Market and 2007-2009 Bear Market are totally fresh in the minds of investors.
2. Historically depressed stock prices, especially among the traditionally most admired companies—True, PE ratios on the S&P 500 Index are the most depressed they’ve been in 26 years.
3. Massive negative psychology among individual and professional investors—True, American Association of Individual Investor’s and Investor Intelligence Polls show that US investors are as negative as in early 2009.
4. Normally successful and admired money managers are called out on the carpet and in some ways humiliated—True, Bruce Berkowitz, Kenneth Heebner, Bill Miller and John Paulson have all come under recent media criticism.
5. Buy and hold investing viewed as an idea that is no longer useful—True, an example is Jonathon Burton’s quote from a recent Marketwatch.com article:

“Stock investing therefore will need to become more nimble and proactive, a far cry from the ‘set-it-and-forget-it,’ buy-and-hold mantra that most individual investors who came of age in the past 30 years have been taught.

“The next decade will likely be one where buy and hold will generally be a fairly poor option in developed markets,” Deutsche Bank analysts told clients in a report last month. “There will be large cyclical rallies punctuated by recessions and funding crises.”

6. Seemingly unsolvable economic problems as part of a deep recession—True, [Grease \(Greece\) is the Word](#).
7. Accommodative Federal Reserve Monetary Policy and fiscally stimulative measures from the U.S. Government—True, Operation Twist and deficit spending.
8. The Public doing 80% of New York Stock Exchange Short Sales—Can’t Track, but public fear measures like VIX, GLD and others are off the charts.
9. Cash in Money Market Funds at record levels in relation to stock market capitalization and paying low interest rates—True (Federal Reserve Z-1 Report)
10. Very intelligent and credible economists and analysts explaining clearly and logically how terrible things are going to be for many years—True, Bill Gross’s October letter.

The last time we were in this situation, the S&P 500 Index went from 676 on March 9, 2009 to a closing high at 1363 on the 29th of April of this year. My math tells me that was a gain of over 100%. We believe it will be different this time. The next Bull Market, in our opinion, will be huge and won’t include the risk on, risk off format. As the US recovery continues and China’s troubles multiply, commodities could plummet and US companies in the Energy, Basic Materials and Heavy Industrial sectors could be dead money at best or huge performance drags at worst. This could be a “bifurcated” market like the one that occurred when Tech stocks plummeted in 2000 and “old economy” stocks rose.

We like our “staple” consumer discretionary stocks like SBUX, DIS, JWN, HRB and CAB. We like Pharmaceutical stocks like MRK, BMY, ABT, PFE and MYL. We like quality financials like WFC, BEN, BRK and AFL. Warren Buffett said last week that the US economy is “very, very unlikely to go back into a recession”. If he is right and we think he is, this could be one of the best set ups for a bull market in my 31 years of working in the US stock market.

Best Wishes,

William Smead

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