BURNS ADVISORY GROUP
private wealth management

The Qualities of an Intelligent Investor
John Burns, CFP
September 2011

Think about this: In terms of real stock market returns, we actually lived through a period worse than the Great Depression. This should matter deeply to all investors, and not just because this September marks the third anniversary of Lehman Bros.' bankruptcy – the event that nearly pushed us over the cliff.

The reason to stress the intensity of the bear market that took place from 2007 to 2009 is because it contains a lesson we must be able to internalize. At only three years removed, our proximity to this "perfect storm" provides us both the context to see how the initial recovery has fared and the time to make intelligent decisions for the years to come.

Most investors fail to recognize the best long term investments in modern U.S. stock markets were made in June 1932 – the month when the Great Crash of 1929 finally stopped crashing. Over the following 30 years, investors who bought S&P 500 stocks realized cumulative real returns of 2,447 percent, and those who owned small cap value stocks gained 13,242 percent over the same period. It's worth noting many who invested in U.S. company stocks during the months and years around June 1932 also did very well over the long term.

The Great Crash was not an isolated occurrence. By definition, strong multi-year stock market recoveries follow major bear markets. It's a perfectly reasonable phenomenon driven by the most unreasonable of reactions – panic selling. Investors sell stocks just to be rid of them regardless of what they're worth or the price they receive. It's peculiar that in order to avoid financial pain, investors sell their stocks at plummeting prices, thus realizing their fear.

But the investor who holds their stocks or buys from the panic sellers at lower prices is rewarded during the eventual recovery. This lesson is the key to intelligent long-term investing.

The S&P 500, with a current forward Price-to-Earnings (P/E) ratio of about 12, could be considered "on sale" right now. Its historical average P/E is about 15.5, which indicates U.S. stocks are priced attractively by at least this measure. This does not guarantee stock prices will increase but suggests irrational selling has pushed them lower than they would be under normal circumstances. This could signal an opportunity for the intelligent investor.

Falling stock prices also signify fewer investors are willing to buy company stocks for the incentive provided by company earnings, which are on the cusp of breaking their high water mark. U.S. companies also have more cash on their balance sheets than at any time in the past – a key indicator of corporate health and their ability to weather economic sluggishness – but this too is lost on many investors.

Those unwilling to own stocks are flooding into two areas – gold and U.S. Treasuries – despite clear signs both have run far too long in a short period.

Gold, despite its safe haven status, demonstrated over the past several weeks it can be even more volatile than stocks. To purchase it requires a suspension of the most basic investment reasoning; gold provides no dividend, fixed yield, earnings yield, or income of any kind. Gold's owners, whether they realize it or not, have bought into the greater fool theory and must hope somebody is willing to pay more than they were.

U.S. Treasuries offer one great investment quality: They are the unrivaled risk-free investment choice for investors all over the world. Because of this special status, investors have come to expect very little in return, and the Treasury market has accommodated that flexibility.

The 10-year U.S. Treasury yield fell to an all-time low of 1.91 percent earlier this month, which means investors were willing to lock up their money for the next decade for less than 2 percent per year in return. Inflation, at about 3 percent per year, will outpace this meager yield and eat away at the investor's purchasing power year after year.

An intelligent investor must be able to offer an argument why an investment choice should offer the reasonable possibility of attractive returns. The simple act of buying a stock for less than it cost before, provided it's reasonably priced, makes it a more valuable investment because the gains or income it produces were purchased at a lower price.

When the thundering herd sells out of stocks without regard for price and turns to safe havens en masse, an intelligent investor should begin to consider that stocks are beginning to look appealing again.

This article is limited to the dissemination of general information pertaining to Burns Advisory Group's ("BAG") investment advisory services and general economic market conditions. The information contained herein should not be construed as personalized investment advice, and should not be considered as a solicitation to buy or sell any security or engage in a particular investment strategy. Past performance is no guarantee of future results, and there is no guarantee that the views and opinions expressed in this article will come to pass. Individual client needs, asset allocations and investment strategies differ based on a variety of factors. BAG is neither a law firm, accountant nor tax adviser. We recommend that you seek the advice of a qualified attorney, accountant or tax advisor for legal or tax services.

BAG is an SEC registered investment adviser with its principal place of business in the State of Oklahoma. BAG and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which BAG maintains clients. BAG may only transact business in those states in which it is noticed filed, or qualifies for an exemption or exclusion from notice filing requirements. Any subsequent, direct communication by BAG with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of BAG, please contact BAG or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about BAG, including fees and services, send for our disclosure statement as set forth on Form ADV using the contact information herein. *©2011 Burns Advisory Group. All rights reserved.*