

Learning is So Hard to Do

July 24, 2006

Pardon a personal experience, please. The chart below paints a picture of extreme interest for me as it mirrors my career in the financial arena. After deciding that being a CPA did not fit my personality (or to be more correct, my lack of patience), becoming an account executive with a local firm in 1955 seemed more suited to my taste. After five years of selling common stocks to people who didn't want them, I left the brokerage business to become a fee-based portfolio manager. Over the period from 1955 to 2000 we have come full circle, with reference to asset allocation.

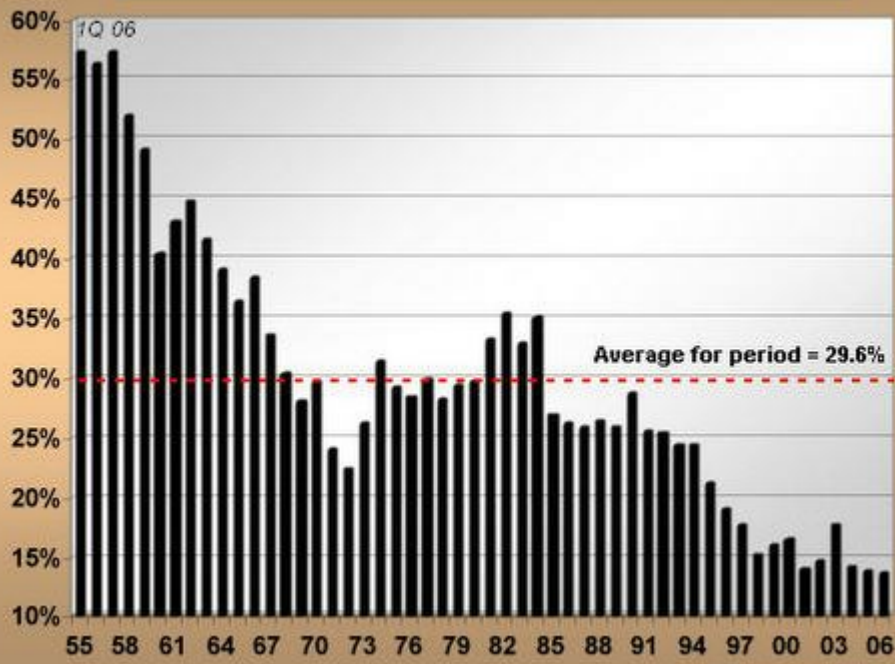
In 1955 people with money still remembered the stock market crash of 1929 and the great depression that followed. Getting them to invest in common stocks, which were extremely cheap back then, was difficult to do. Everyone wanted government bonds. They remembered the story of Sewell Avery, board chairman of Montgomery Ward, who was literally carried out of his office in his chairman's chair for refusing to expand their number of stores for fear of a post WW II depression. In 2000, 45 years later, when Central Plains Advisors resigned all their equity accounts due to extreme overvaluation, nobody wanted government bonds. The reasons given were common stocks always out perform bonds, prosperity a given, and inflation would be with us forever. Buying stocks on dips has always worked out in obtaining good returns. Government bonds in the 50's, not stocks, was the way to go. And now, in the beginning of the 21st century, common stocks are the preferred asset.

Do you see a pattern here? Academe, Wall Street, and the consulting industry have forced the common stock market for 45 years, while at the same time paying little to no attention to bonds (please note the chart). Valuations apparently didn't make a difference. Common stocks now and forever, regardless of price. Think of it, in 1981 when I was buying long-term government bonds with a 14% coupon, many members of the investment committee questioned my judgment. This despite the fact that 14% was 40% better than the average return on common stocks as far back as 1925.

Today, we are facing an extremely difficult economic environment. Corporate profits, we believe, are peaking, both as a percentage of the GDP as well as absolutely. Debts are at levels never seen before and real disposal income increases are non-existent. Yet, here we are again. Academe, Wall Street and the consulting firms have private pension funds owning less than 15% in bonds, as opposed to near 60% in 1955. Shouldn't it be the other way around? We think so.

The more things change, the more they stay the same. No wonder defined benefit pension plans are in trouble. Humans, it seems, are slow learners.

Fixed Income As % Of Private Pension Fund Assets



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