



FISHER INVESTMENTS™ on INDUSTRIALS



- An in-depth look at the global Industrials sector investment universe including conglomerates, machinery producers, electrical equipment manufacturers, defense contractors, railroads, and more
- Tips and tools for security analysis and portfolio management
- A useful guide for investing in any market condition

Foreword by *New York Times* bestselling author Ken Fisher

Fisher Investments on Industrials

FISHER INVESTMENTS PRESS

Fisher Investments Press brings the research, analysis, and market intelligence of Fisher Investments' research team, headed by CEO and *New York Times* best-selling author Ken Fisher, to all investors. The Press covers a range of investing and market-related topics for a wide audience—from novices to enthusiasts to professionals.

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Fisher Investments on Industrials

**Fisher Investments
with
Matt Schrader and
Andrew S. Teufel**



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Foreword

Welcome to the fourth in a series of investing guides from Fisher Investments Press—the first ever imprint from a money manager, produced in partnership with John Wiley & Sons. This particular guide is on one category of stocks—Industrials—the most diverse of all the standard investing sectors. Those newer to investing will immediately think of heavy machinery and manufacturing—and maybe airplanes. But this broad sector also hits bridges and tunnels, defense, transportation services, and even light bulbs and package delivery.

Another interesting feature about Industrials: Industrials firms overwhelmingly have customers in other businesses and governments. They're not heavily retail-oriented—the way Health Care, Consumer Staples, or Consumer Discretionary firms are. Instead, these firms produce huge machinery or other complex products—with big sticker prices. And for this reason, out of all the sectors, Industrials has historically been among the most economically sensitive, and most correlated to the broader market. When you think about those big ticket items, it makes sense. If Machinery and Defense firms anticipate rough economic times, they're less likely to spend big money to update equipment. Which is why it's important to not only understand what drives Industrials, but also what drives their end-customers' spending plans. This book details what to look for.

But it's not as simple as anticipating economic cycles. Each industry has unique drivers. And because the life-cycle for many Industrials products can be long—regardless of the economy—and how long-term contracts are negotiated also plays a role, it's important to learn to anticipate where demand is coming from next. This book shows you how.

Manufacturing globally has been evolving tremendously over the past few decades, and continues to evolve. This book provides background on the modern production process—from lean manufacturing to Six Sigma—to help you understand how we got here and how it’s likely to continue evolving. A significant theme is globalization and liberalization of trade policy, which helped give rise to the Asian Tigers (as detailed here)—and which will give rise to the next round of global tigers.

What this book doesn’t provide is hot stock tips or a simple to-do list for picking the right stocks. Such a thing doesn’t exist. Instead, this book, and all the books in the series, aims to give you a workable, top-down framework for analyzing a sector. The framework gives you tools allowing you to use commonly-available information to uncover profitable opportunities others overlook. And those opportunities should allow you to make market bets relative to an appropriate benchmark that win more often than lose. This isn’t a framework that goes stale. Rather, this is a scientific method that should serve you all throughout your investing career. So good luck and enjoy the journey.

Ken Fisher
CEO of Fisher Investments
Author of the *New York Times*
Best Sellers *The Ten Roads to Riches* and
The Only Three Questions That Count

Preface

The *Fisher Investments On* series is designed to provide individual investors, students, and aspiring investment professionals the tools necessary to understand and analyze investment opportunities, primarily for investing in global stocks.

Within the framework of a “top-down” investment method (more on that in Chapter 7), each guide is an easily accessible primer to economic sectors, regions, or other components of the global stock market. While this guide is specifically on Industrials, the basic investment methodology is applicable for analyzing any global sector, regardless of the current macroeconomic environment.

Why a top-down method? Vast evidence shows high-level, or “macro,” investment decisions are ultimately more important portfolio performance drivers than individual stocks. In other words, before picking stocks, investors can benefit greatly by first deciding if stocks are the best investment relative to other assets (like bonds or cash), and then choosing categories of stocks most likely to perform best on a forward-looking basis.

For example, a Technology sector stock picker in 1998 and 1999 probably saw his picks soar as investors cheered the so-called “New Economy.” However, from 2000 to 2002, he probably lost his shirt. Was he just smarter in 1998 and 1999? Did his analysis turn bad somehow? Unlikely. What mattered most was stocks in general, and especially US technology stocks, did great in the late 1990s and poorly entering the new century. In other words, a top-down perspective on the broader economy was key to navigating markets—stock picking just wasn’t as important.

Fisher Investments on Industrials will help guide you in making top-down investment decisions specifically for the Industrials sector. It shows how to determine better times to invest in Industrials, what Industrials industries and sub-industries are likelier to do best, and how individual stocks can benefit in various environments. The global Industrials sector is complex, covering many sub-industries and countries with unique characteristics. Using our framework, you will be better equipped to identify their differences, spot opportunities, and avoid major pitfalls.

This book takes a global approach to Industrials investing. Most US investors typically invest the majority of their assets in domestic securities; they forget America is less than half of the world stock market by weight—over 50 percent of investment opportunities are outside our borders. This is especially true in Industrials as many of the world's largest firms are based in foreign nations. Even domestic Industrials are relying more on manufacturing outside of the US and are deriving a significant portion of their profits overseas. Given the vast market landscape and diverse geographic operations, it's vital to have a global perspective when investing in Industrials today.

USING YOUR INDUSTRIALS GUIDE

This guide is designed in three parts. Part I, “Getting Started in Industrials,” discusses vital sector basics and Industrials’ high-level drivers. Here we’ll discuss Industrials’ main drivers—government and corporate spending—and explain how to capitalize on a wide array of macro conditions and industry-specific features to help you form an opinion on each of the industries within the sector. We’ll also discuss additional drivers affecting the sector that ultimately drive Industrials’ stock prices.

Part I also includes a discussion on the history of modern manufacturing since 1950 and what has shaped the world’s current manufacturing landscape. Topics discussed include globalization, the rise of Asia, and the importance of manufacturing in the US today.

Part II, “Next Steps: Industrials Details,” walks through the next step of sector analysis. We’ll take you through the global Industrials sector

investment universe and its diverse components. The Industrials sector is arguably the most diverse sector, which makes a thorough analysis challenging, but also increases your chances of finding successful investment opportunities and profitable segments of the market.

There are currently 14 industries within the Industrials sector. We will take you through the major components of the sector in detail, including a discussion on their end-markets, how they operate, and what drives profitability—to give you the tools to determine which industry will most likely outperform or underperform looking forward. Note: We spend less time on the Commercial Services & Supplies industry group, as it makes up a very small portion of the sector and the global stock market.

Part II also details where to find and how to interpret publicly available industry data. There are ample free resources, websites, and data sources to help in making better forward-looking sector, industry, and stock decisions.

Part II concludes with a discussion about the global infrastructure markets including the drivers and risks behind investment, the benefits to the Industrials sector, and ways to participate in the infrastructure boom.

Part III, “Thinking Like a Portfolio Manager,” delves into a top-down investment methodology and individual security analysis. You’ll learn to ask important questions like: What are the most important elements to consider when analyzing Machinery and Defense? What are the greatest risks and red flags? This book gives you a five-step process to help differentiate firms so you can identify ones with a greater probability of outperforming. We’ll also discuss a few investment strategies to help determine when and how to overweight specific industries within the sector.

Note: We’ve specifically kept the strategies presented here high level so you can return to the book for guidance no matter the market conditions. But we also can’t possibly address every market scenario and how markets may change over time. Many additional considerations should also be taken into account when crafting a portfolio strategy, including your own investing goals, your time horizon, and

other factors unique to you. Therefore, you shouldn't rely solely on the strategies and pointers addressed here, as they won't always apply. Rather, this book is intended to provide general guidance and help you begin thinking critically not only about the Industrials sector, but about investing in general.

Further, *Fisher Investments on Industrials* won't give you a "silver bullet" for picking the right Industrials stocks. The fact is the "right" Industrials stocks will be different in different times and situations. Instead, this guide provides a framework for understanding the sector and its industries so that you can be dynamic and find information the market hasn't yet priced in. There won't be any stock recommendations, target prices, or even a suggestion whether now is a good time to be invested in the Industrials sector. The goal is to provide you with tools to make these decisions for yourself, now and in the future. Ultimately, our aim is to give you the framework for repeated, successful investing. Enjoy.

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GETTING STARTED IN INDUSTRIALS

INDUSTRIALS BASICS

Mr. Grant started his Sunday morning with some housework—taking out the trash, mowing the lawn, cleaning the pool, changing light bulbs, installing cabinets, and fixing the air conditioner.

It was a productive day until 2:00 PM when his shoulder cushioned a fall off his ladder, requiring a trip to the ER. Making matters worse, Mr. Grant's normal route was getting re-paved, forcing him to take the long way through a \$5 toll road to the hospital.

The bad news: He needed an MRI and a shoulder specialist—the closest was an hour's plane flight away.

Early Monday, he took the train to the airport and boarded a jet. At the hospital, he got his MRI, and the doctor told Mr. Grant his shoulder would be fine in time. Mr. Grant celebrated with a shopping spree through the airline's gift catalogue, fixing Post-it notes on everything he wanted to buy.

This is more than a simple anecdote with a happy ending—it's an illustration of the importance of Industrials products in our everyday lives. Every event, action, and item in Mr. Grant's travails used products and services, from the Industrials sector. Table 1.1 lists just some of the Industrials products and services Mr. Grant encountered.

Table 1.1 Industrials Sector Impact on Mr. Grant

Action	Industrials Sector Involvement
Taking out the trash	Pick-up service provided by a Commercial Services & Supplies company
Mowing the lawn	Lawnmower made by a Machinery company
Changing light bulbs	Light bulb manufactured by an Electrical Equipment company
Installing cabinets	Cabinets manufactured by a Building Products company
Fixing the air conditioner	Air conditioner manufactured by an Aerospace & Defense company
Road getting re-paved	Road paving equipment manufactured by a Machinery company
Paying \$5 on the toll road	Toll road operated by a Transportation Infrastructure company
Taking the train to the airport	Train manufactured by a Machinery company and operated by a Road & Rail company
Taking the plane flight	Plane manufactured by an Aerospace & Defense company and operated by an Airline
Getting an MRI	MRI machine manufactured by an Industrial Conglomerate
Shopping from an airplane catalogue	Package delivery services provided by a Air Freight & Logistics company

The Industrials sector, arguably more than any other, is vastly diverse. Because it’s not focused on a particular product or service, myriad drivers, end markets, and operating conditions can impact profitability of Industrials firms. And, while diverse, Industrials have played a very important role in global economic development. The sector has progressed globalization and global trade, it has built the world’s infrastructure and boosted quality of life, and it has driven significant gains in productivity and manufacturing efficiency.

INDUSTRIALS BASICS

What does the Industrials sector look like from a high level? Because it has many diverse industries, it’s split into three broad categories (as defined by the Global Industry Classification Standard [GICS])

classification system). Firms in these categories primarily serve governments and corporations, but in some cases serve consumers as well:

- Capital Goods
- Transportation
- Commercial Services & Supplies

Capital Goods, the largest sector component, consists primarily of firms involved in production and making machinery and industrial goods including airplanes, tractors, power generators, and defense and transportation equipment. Globally, there are over 4,300 publicly traded Capital Goods firms.¹

Transportation firms, the second largest weight within the sector, mostly ship goods rather than make them. Most forms of transportation are included in this group, including planes, trucks, ships, and railroads. Globally, there are nearly 900 publicly traded Transportation firms.²

Last, Commercial and Professional Services are a mixed bag, including commercial printing, data processing, environmental waste and garbage pickup, janitorial services, and staffing services. While seemingly disparate, these firms are generally service focused. Globally, there are over 1,000 publicly traded firms classified as Commercial and Professional Services.³

Industrials by the Numbers

The 200 largest Industrials companies employ over 11.5 million people globally—greater than the populations of Greece, Sweden, Switzerland, Hong Kong, Israel, or Denmark.

These firms generated over \$3.1 trillion in revenues in 2007—larger than the size of the entire economy of every country in the world except the US, Japan, Germany, and China. And they had over \$5.1 trillion worth of assets—more than the value of all durable goods (goods meant to last more than three years) owned by US households and nonprofit organizations.

Source: Bloomberg Finance L.P.; CIA 2008 World Fact Book; US Federal Reserve; IMF World Economic Outlook Database.