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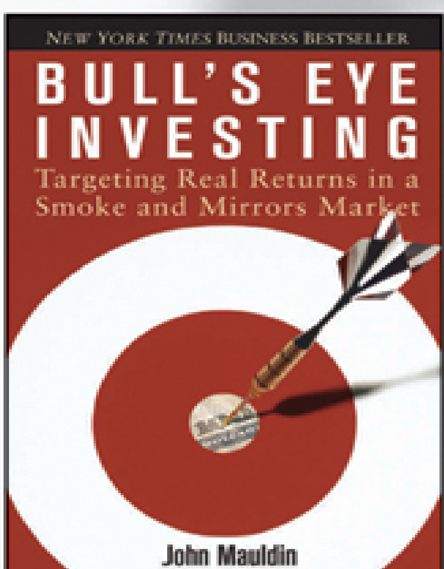

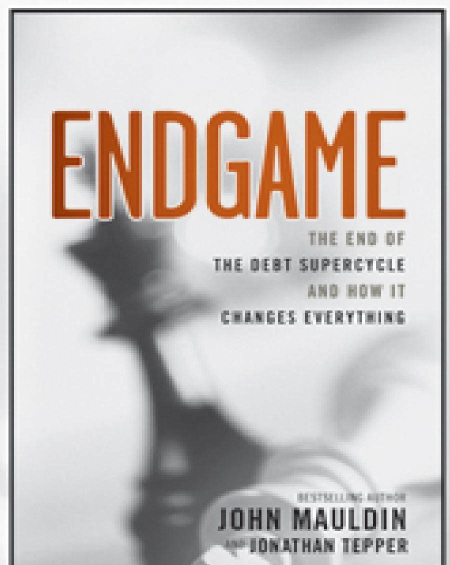

JOHN MAULDIN

NATIONAL BESTSELLING AUTHOR

New Foreword by John Mauldin

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FOREWORD

Those of you who have been reading *Thoughts from the Frontline*, the weekly newsletter I have been publishing for more than a decade, know that I am a constant observer of the global economy, sorting through a massive amount of information each week. Over the decades, I have watched stock markets rise and fall, interest rates climb and decline, housing markets reach unprecedented highs and lows, and more recently, debt crises threaten the financial stability of entire countries. And not only do I write about these events in my newsletter, I have also penned five books on finance and investing, often predicting the ebb and flow of the tide before major events and detailing how I came to my conclusions.

In today's increasingly complex and interconnected world, you need to have a broad perspective on the financial markets. You should pay attention to what is happening in China or Greece or Brazil because global events can impact the performance not only of the stock market, but also of every part of your investment portfolio. To make more informed investment choices, you must understand the global markets—where they were, where they are, and where they're likely to head.

Making sense of all the available economic and other data can be daunting. I hope that my analysis is lucid enough to provide you with a solid perspective so that you can be a shrewder investor, whether you're investing on your own or with the guidance of an advisor.

John Wiley & Sons, my publisher, has assembled this e-Book set of three of my best-selling books. Included here are *Bull's Eye Investing: Targeting Real Returns in a Smoke and Mirrors Market*; *Just One Thing: Twelve of the World's Best Investors Reveal the One Strategy You Can't Overlook*; and

Endgame: *The End of the Debt SuperCycle and How It Changes Everything*, which I co-authored with Jonathan Tepper.

Endgame was published in 2011 and focuses more closely on the collapsing economies around the world. The two other books were first published more than five years ago, but the information and insights in them are timeless and still valuable for anyone interested in the world of finance.

I'm fortunate enough to have worked and interacted with some of the best minds in business today and they have helped me shape my views. And you—my readers—have responded with both enthusiasm and skepticism, calling me out when you disagree with my views and correcting me when my calculations have errors. But most of all, you have asked me to continue to speak and write on what is happening around the world.

Whether you're sitting in your backyard in La Jolla, California, flying to Singapore, or riding the subway in New York, these three e-Books will provide you with a mix of history, investment knowledge, and hopefully, some humor along the way.

John Mauldin

May 2012

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John Mauldin

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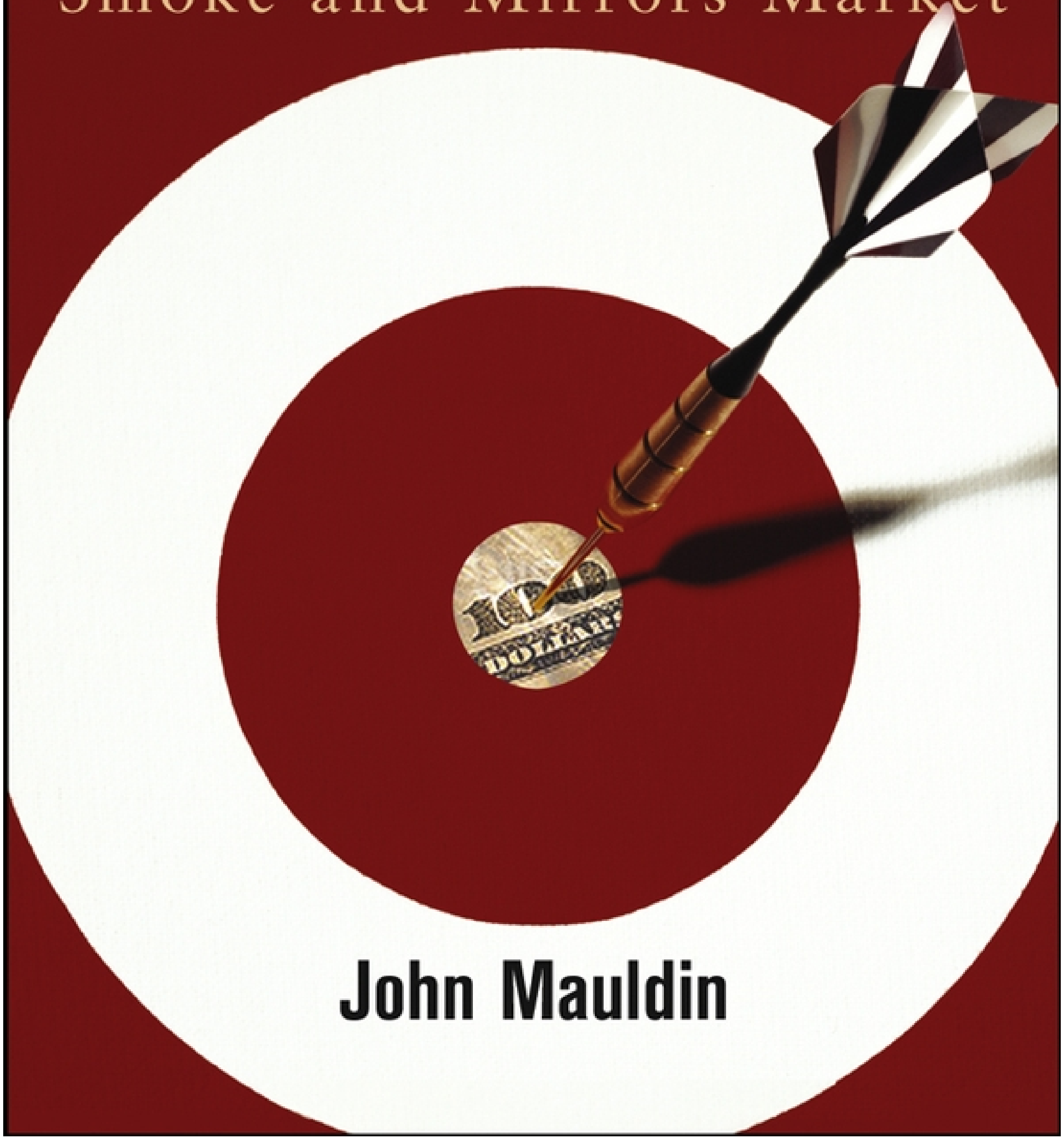
BULL'S EYE INVESTING

Targeting Real Returns in a Smoke and Mirrors Market



John Mauldin

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To Eunice, who keeps me on target

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There were a number of people whose ideas directly contributed to significant parts of this book. Rob Arnott, Ed Easterling, James Montier, and Michael Alexander all contributed important ideas and in some cases the basic ideas for whole chapters and sections.

I regularly read a number of writers whose ideas permeate this book as they have helped shape my thinking. I am especially grateful to my friends and fellow analysts Bill Bonner, Art Cashin, Dennis Gartman, Bill King, Richard Russell, and Greg Weldon for their daily commentaries.

I regularly read and should note the work and writings of Martin Barnes, Peter Bernstein, Lord Alex Bridport and Roy Damary in Geneva, Chuck Butler, Mark Faber, Bill Gross, Gary Halbert, Michael Lewitt, Paul McCulley, Gary North, Barry Ritholtz, Stephen Roach, Gary Shilling, Steve Sjuggerud, and Porter Stansberry.

I should note that none of these writers is responsible for any of the errors, wrong notions, or failed forecasts in the book. Those are all mine.

I mention a number of important books and newsletters in Appendix A that have helped me in my thinking and may be of value to you.

Thanks to my editor at Wiley, Debra Englander, for bearing with me through busted deadlines and working with me even when the book came in at twice the size. I have to mention my associate Harry Ward, who helped with the research, writing, and all the hard work of doing graphs, checking facts, getting permission for quotes, and so on. Thanks to Wayne Anderson for his editing help and to my daughter and assistant Tiffani for handling the details, and even more so to my bride (and favorite Canadian export) Eunice who keeps the operations flowing.

Many thanks to Jon Sundt, Matt Osborne, and Bob Amedeo at Altegris Investments, with whom I partner on the investment business side of my life, for letting me be absent for long periods, which probably cost them far more money than I will ever get in royalties.

Mike Casson, my e-letter publisher at Investor Insights, gets a special thanks as his hard work has made it possible for me to have such a large Internet readership and exposure.

Many readers offered thoughtful comments, suggestions, and criticisms, and I am grateful to all of you.

Introduction

> *"Would you tell me, please, which way I ought to go from here?"*
>
> *"That depends a good deal on where you want to get to," said the Cheshire Cat.*
>
> *"I don't much care where—" said Alice.*
>
> *"Then it doesn't matter which way you go," said the Cat.*
>
> *"—so long as I get somewhere," Alice added as an explanation.*
>
> *"Oh, you're sure to do that," said the Cat, "if you only walk long enough."*
>
> —Lewis Carroll, *Alice's Adventures in Wonderland*

Every hunter knows that you don't shoot where the duck is, but where the duck is going to be. You've got to "lead the duck." If you aim where the duck is at the moment you shoot, you will miss your target (unless the duck is flying very slowly or is very close!).

Bull's Eye Investing simply attempts to apply that same principle to investing. In this book, I hope to give you an idea of the broad trends that will be evident for the remainder of the decade and help you target your investments to take advantage of these trends.

Successful investing for the period 2004 through 2010 will require you to do things differently than you did in the 1980s and 1990s. We started the last bull market with high interest rates, very high inflation, and low stock market valuations. All the elements were in place to launch the greatest bull market in history.

Now we're in the opposite environment. The stock market has high valuations, interest rates have nowhere to go but up, the dollar is dropping, and the twin deficits of trade imbalance and government debt stare us in the face.

Which way is the stock market going? Which way are bonds going? Gold? Real estate? Where should I invest?

Wall Street and the mutual fund industry say, "The market is going up; you should buy stocks and now is the time to buy. You can't time the markets, so you should buy and hold for the long term. Don't worry about the short-term drops. And my best advice is to buy my fund."

The folks on Wall Street are in the business of selling stocks because that is how they make their real money. Whether the shares are sold directly or are packaged in mutual funds or as initial public offerings (IPOs) or in wrap accounts or in variable annuities or in derivatives, these folks primarily want to sell you some type of equity (stock), preferably today. Unfortunately, the vast majority of investors believe these pitches and don't know there are better investment alternatives.

Their advice—buy what they sell—has been the same every year for a century. And it has been wrong about half the time. There are long periods of time when stock markets go up or sideways and long periods of time when markets go down or sideways.

These cycles are called secular bull and bear markets. ("Secular" as used in this sense is from the Latin word *saeculum,* which means a long period of time.) Each cycle has different types of good investment opportunities. We are currently in just the first few innings of a secular bear market. The problem for Wall Street is that the products brokers primarily sell do not do well in secular bear markets. So they have to tell you that things will get better so you should buy now. Or they advise you to "have patience, and please give us more of your money."

In secular bull markets investors should focus on investments that offer *relative returns.* By that I mean we should look for stocks and funds that will perform better than the market averages. The benchmark by which you measure your investment strategy is the broad stock market. If you "beat the market," you are doing well. Even though there will be losing years, staying invested in quality stocks will be a long-term winner.

In secular bear markets, that strategy is a prescription for disaster. If the market goes down 20 percent and you go down only 15 percent, Wall Street proclaims your performance to be "winning." But you are still down 15 percent.

In markets like those we face today, the essence of Bull's Eye Investing is to focus on *absolute returns.* Your benchmark is a money market fund. Success is measured in terms of how much you make above Treasury bills. In secular bear markets, success is all about controlling risk and carefully and methodically compounding your assets.

Some will say, as they say each year, that the bear market is over: that this book is writing about ancient history. But history teaches us that is not the case. Secular bear markets can have drops much bigger than we have already seen, and last for up to 17 years. The shortest has been eight years. They have never been over when valuations have been as high as they are today.

Investors who continue to listen to the siren song of Wall Street will be frustrated at best, in my opinion, as the research I present clearly shows we have a long way to go in this bear market cycle. For those who plan to depend on their stock market investments for retirement within a decade, the results could be particularly devastating.

Bull's Eye Investing is not, however, some gloom and doom book. Despite what Wall Street wants you to believe, there is no connection between how the economy will do and how the stock market will perform. As we will see, the economy should be fine, with just the usual corrections sandwiched between periods of growth. The world as we know it is not coming to an end. It is merely changing, as it always has. There are numerous possibilities for investment growth in a secular bear market. They just don't happen to be in the standard Wall Street fare.

What I hope to do is give you a road map to the future by looking at how and why markets have behaved in the past. We will debunk many of the myths and "scientific studies" used by Wall Street to entice investors into putting their money into buy-and-hold, relative return investments. The Wall Street insiders, not surprisingly, use theories, statistics, and so-called facts that are blatantly biased and in many cases just plain wrong. When the market goes down, they just shrug their shoulders like Chicago Cubs (or my own Texas Rangers) fans and say, "Wait till next year. And buy some more, please."

Basically, in the first half of the book I am going to teach you how to fish, and in the second half I am going to tell you where the fish are. I would politely suggest that you not skip the first half of the book—do not turn to the last part simply looking for the quick investment fix. If you don't understand what is happening in the economy and world markets, you will not have confidence in your investment strategy and you'll end up chasing the latest hot investment, which is usually a prescription for pain in any type of market.

Here's how this book is organized:

First, we look at what history teaches us about the potential for stock market returns over the rest of this decade. We examine six major (and very different) ways to look at the stock market. As a quick preview, the evidence is heavily weighted to suggest that at the end of this cycle the stock market will not be too far from where it is today. The historical and mathematical analysis of bubbles also suggests that we could see the stock market drop much further before beginning the next bull market. We examine several of Wall Street's favorite sales tools, the famous Ibbot-son study,[a] Jeremy Siegel's *Stocks for the Long Run,* and Modern Portfolio Theory (MPT), and see why you should exercise extreme caution when they are used in a sales presentation.

We then look at why the economy can do just fine and stock markets still can fall: It all has to do with the expectation for earnings and the value investors put on those future earnings.

Most analysts track a simple bear market from peak to trough (top to bottom). Bear markets (or 20 percent plus corrections) can happen in secular bull periods (think 1987 or 1998), just as bull markets (20 percent plus up reversals) can happen in secular bear markets (think 2000, 2001, 2002, 2003). Analysts also view a secular bear market as the lengthy period over which the market makes a top, enters into a decisive down phase, and then once again returns to the old high.

I suggest that we view a secular bear market a little differently, as the period in which the price-earnings (P/E) ratio goes from very high to quite low. It is in these periods of low valuation that we can once again begin to confidently put our money back into stocks, as the rubber band is getting ready to snap back. Of course, Wall Street folks will trot out all sorts of studies that show that stocks are always undervalued and you should buy today. They did so in 2000, 2001, and 2002, and 2003. They are doing so as this book is written and published. They are wrong, and we will examine why they're wrong.

That means earnings are important, and thus a few chapters focus on earnings. We see why Wall Street analysts are so consistently wrong (by about 50 percent per year too much), what the prospects for real earnings growth are, and how to put it all into perspective.

Next, we look at risk. As I've said, investing in secular bear markets is all about controlling risk. I believe this chapter is one of the most important in the book, but it may also be the most fun.

We discuss the most common mistakes investors make and how to avoid them. Statistics show that investors do not do as well as the funds or stocks they invest in, and we look at the causes. We examine why today's hot fund is likely to be tomorrow's loser, and what types of funds you should be looking for in this market.

We look at the future, including the demographics of the baby boomer generation, and how it will impact our investment potential. We analyze the direction of interest rates, deflation, and inflation. Then we examine the world economy and the dollar and see if we can find a potential winning theme (we do!).

The consequences of these economic problems will require some painful adjustments from those who do not make the effort to protect themselves. I show you where and how to turn problems into opportunities by seeking absolute returns in turbulent markets.

After the first section, the book focuses on specific types of investments. After telling you why we are in a secular bear market for stocks, Chapters 16 through 18 explain precisely how to invest in stocks today. Ironically, in a secular bear market, the little guy has a big advantage over the larger institutions and funds. There are great opportunities in the stock market if you know where to look. During the last secular bear market, companies like Microsoft and Intel were launched. I show you a simple way to find the hidden gems sought after by the savviest investors.

Then we look at the world of fixed income investments. The rules are changing, and what worked in the 1980s and 1990s will in all likelihood be a losing proposition for the remainder of this decade.

We then analyze what are, in my opinion, some of the better potential sources of absolute returns: certain types of hedge fund styles. We look at how Wall Street has rigged the market against small investors getting the best deals. The richest investors and largest institutions with the best-paid advisors choose these high-fee, unregulated private investments because they deliver better risk-adjusted performance than oneway buy-and-hold mutual funds. We show you how to find and gain access to these private funds, and how to use some of their strategies in your own portfolios.

Finally, we take a more thorough look at the future, and why you should be optimistic. In 1974, only a few people saw the changes and opportunities that computers, telecommunications, and the Internet would bring. The world was bemoaning the losses of basic American industry as jobs were being lost to world competition.

Today, we find ourselves once again faced with serious competition for American jobs. Our core seems to be slipping away, as the market doesn't respond. The world sees us in a much different light than just a few years ago. Few notice the new revolutions that are happening in small firms and research departments that will form the basis for the next wave of American prosperity because we haven't even begun to imagine the ways in which the next waves of change will affect us.

Will there be winners and losers in this process? Of course. Anytime there are periods of upheaval and great change, there are always those who benefit from the change and those who suffer. I will try to show you how you can position yourself to be a winner.

There is a centuries-long, if not millennia-long, pattern to these cycles. Good markets are followed by bad markets, which are again followed by good markets. They are as predictable as winter and summer. These cycles have been