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—*Rich Karlgaard, Publisher,* Forbes *Magazine*

THE LITTLE BOOK *of* BULL'S EYE INVESTING

Finding Value, Generating Absolute Returns, and Controlling Risk in Turbulent Markets

JOHN MAULDIN

National Bestselling Author of *Endgame*

THE LITTLE BOOK OF BULL'S EYE INVESTING

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To

Art Cashin

Greatest of Raconteurs, Finest of Teachers, Best of Friends

Contents

Acknowledgments

From South Africa in the BA lounge. Always working for you guys.

In a book with as many sources as *Bull's Eye Investing,* it goes without saying that there are many people from whom I am constantly learning and who are great influences on my thinking. I am lucky in that so many people take the time to patiently help me understand the significance of various pieces of the puzzle and how they fit together. *Bull's Eye* in particular owes a great deal to Ed Easterling, James Montier, and Rob Arnott. The idea for taking a rather large tome like the original *Bull's Eye Investing* and making the best parts into a Little Book came from my extremely patient editor at John Wiley & Sons, Debra Englander. Deadlines come and go at least for me, but a good editor is hard to find.

And speaking of editors, I must gratefully acknowledge the masterful work of Terry Coxon, who took a very rough collection of material and turned it into a book and greatly improved upon the original writing while doing so, gently prodding me to be more clear in my prose. To have someone of his talent take the time under deadline pressures is most amazing, and I am grateful in the extreme.

And to those who said kind words about the original book and helped turn it into a best seller and a great career break for a little-known author, I will always be grateful. Without your acknowledgment, this Little Book would never have come about.

An Introduction to Bull's Eye Investing

"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.

". . . just 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 YOU don't shoot where the duck is; you shoot 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'll miss it.

Bull's Eye Investing simply attempts to apply that same principle to the markets. In this book, I hope to give you an idea of the broad trends that I believe are at work now and will persist for the remainder of this decade. Then I'll help you target your investments to take advantage of those trends.

Through the Looking Glass

When I was invited to do this *Little Book of Bull's Eye Investing*, I wondered whether the original *Bull's Eye Investing* (written nine years ago and dense in data and research, and not little at all) could be shortened and still deliver what put the book on the best-seller lists and earned it the top spot on *Forbes* publisher Rich Karlgaard's roll call of the decade's most important books on investing. It has since been published in several foreign languages and is still in print.

Thinking about doing the *Little Book* made me go back and carefully read the original, and I was pleased to find how much of it is still useful today. Much of the research that it reports is timeless and still will be valuable a generation from now. Many of the predictions, whether by luck or skill, were spot on. We are still on the path I mapped out but are much further along it. The task for the *Little Book* is to collect the parts that have held up well and then bring things up to date, and introduce new readers to the concept of Bull's Eye Investing.

As I write this introduction (the final element), I've just come from Hong Kong, where *Bull's Eye Investing* has something of a serious following. Publishers are eager to do a Chinese-language version for distribution in Hong Kong and the mainland. The principles of the long-term ebb and flow of markets really do work wherever human beings are involved in investing, which is to say, everywhere.

Successful investing for the remainder of this decade will mean doing things differently from what people did so profitably in the 1980s and 1990s and from what Wall Street is still telling people to do. We started the last bull market, in 1980, 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.

The environment now is just the opposite. Stock market valuations are still relatively high (though well down from the stratosphere where they were flying at the beginning of the decade), and interest rates will eventually have to go up. In addition, gold is volatile, as is the dollar against other currencies, and the twin deficits of trade and government debt stare us in the face.

Everything Is *Not* Relative

So which way is the stock market going? And how about bonds? Gold? Real estate? Where should you invest?

Wall Street and the mutual fund industry say, "The market is going up. You should buy stocks, and now is the time to do it. 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."

Wall Street is like the carpenter who only has a hammer: everything looks like a nail. Those brokers are in the business of selling stocks because that is how they make their real money. Whether they are sold one by one or packaged in mutual funds or as IPOs or in wrap accounts or in variable annuities or in derivatives, what the brokers want to sell you is some type of equity (stock)—and preferably today. They have rigged the rules against investors who would prefer more and safer choices so that most investors are unaware of the options.

Their advice for you to buy what they're selling has been their same advice every year for a century. And it has been wrong about half the time. There are long periods when stock markets go up, but there also are long periods when markets go down or sideways. And by "long," I mean longer than almost anyone is prepared to wait.

These cycles are termed secular bull and bear markets. (Secular as used in this sense is from the Latin *saeculum*, which means a long period of time.) Each cycle has its own good investment opportunities. When I wrote the introduction to *Bull's Eye Investing* in 2003, I said we were entering a secular bear. Now, nine years later, we are in the latter part of that same trend.

The problem with Wall Street is that most of what it sells does poorly in secular bear markets, so most traditional portfolios have suffered since 2000. But they still tell you that things will get better, so buy and keep buying. "Just look at this chart prepared by our independent economists that proves the market will go back up. Just have patience, and please give us more of your money."

In secular bull markets, an investor should search for assets that offer **relative returns**—stocks and funds that will perform better than the market averages. If you beat the market, you're doing well. Even though there will be losing years, the strategy of staying invested in quality stocks during a secular bull market will be a long-term winner.

In a secular bear market, however, that strategy is a prescription for disaster. If the market goes down 20 percent and you go down just 15 percent, you'd be doing relatively well, and Wall Street would call you a winner. Your broker would expect a pat on the back. 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 by how much you make above Treasury bills.

Some will say, as they say each year, that the bear market is over and that the book you are reading is about ancient history. But experience says otherwise. A secular bear market can see drops much bigger than we have already been through, and it can last as long as 20 years. The shortest has been 8 years. *None has ended with valuations as high as they were at the bottom in 2009.* And that touches on one of the novel ideas in this book: bull and bear cycles should be seen in terms of valuations, not price.

Investors who continue to listen to the music from Wall Street will be sorely disappointed, in my opinion, as the facts I will present show that this bear market has years to go. For buy-and-hold investors planning to retire within a decade and live on their stocks, the results could be particularly devastating.

Walking "Long Enough"

Bull's Eye Investing is not, however, about doom and gloom. Despite what Wall Street wants you to believe, there is no reliable connection between how the economy does and how the stock market performs. As we'll see, the economy should muddle through, with just the usual kind of recessions sandwiched between periods of growth. The world as we know it is not coming to an end. It is merely changing as it is always doing. There are numerous possibilities for investment growth while the secular bear market proceeds. You just won't find them on any standard Wall Street menu.

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 so-called scientific studies used by Wall Street to entice investors into putting their money into buy-and-hold, relative return investments. As should be no surprise, they use "facts," theories, and statistics that are carefully selected and in many cases plain wrong. And when the market goes down, they just shrug their shoulders like a Chicago Cubs (or my own Texas Rangers) fan and say, "Wait till next year. And buy some more, please."

Chapter One

It's Good to Be King

But Beware of Tailors Using Invisible Cloth

THE TRADITIONAL WISDOM OF Wall Street is to buy low and sell high. While it sounds simple enough, the philosophy has fostered an entire industry of financial advisors, prognosticators, and experts. When you reflect on the carnage on Wall Street in the last few years, it is easy to place stock market experts in the same category as TV weathermen.