

- It ain't what you don't know that gets you into trouble. Its what you know for sure that just ain't so!

Mark Twain

- “The investor’s chief problem – even his worst enemy – is likely to be himself”

Benjamin Graham

Market truisms

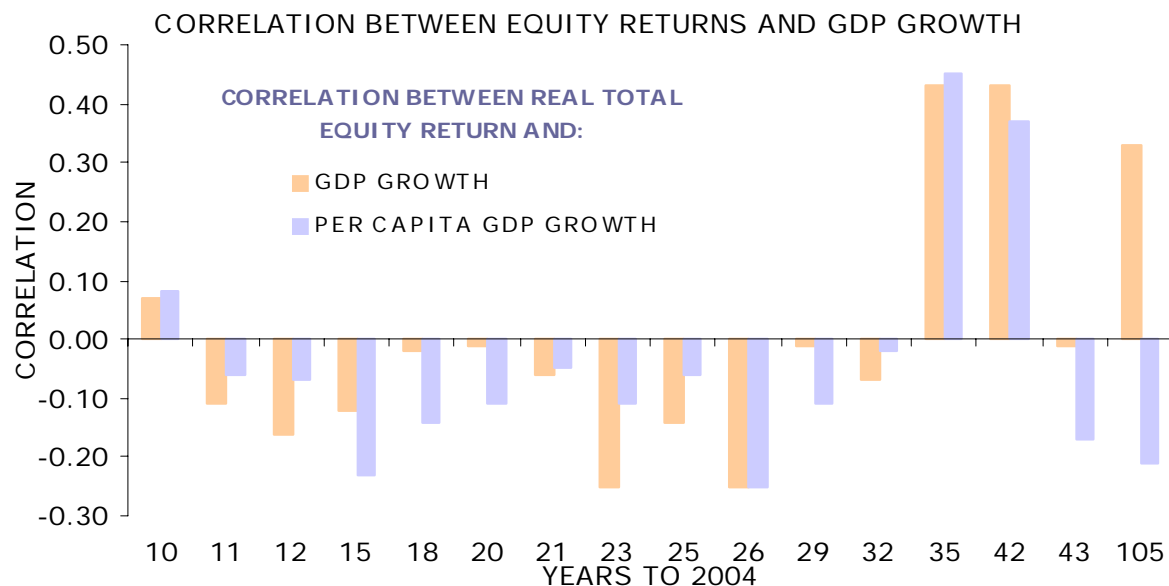
Truism?

- Investing in countries with high GDP growth produces higher equity returns

Fact

- There is no correlation between a country's GDP growth and returns from that country's stock market

(Dimson, Marsh, Staunton and Elgeti, 2005, based on a study between 1900 - 2004)



1900 - 2004		
	Real equity return	GDP
Australia	7.6%	1.9%
USA	6.6%	2.0%
Japan	4.2%	3.6%
France	3.4%	2.2%
Italy	2.3%	2.7%

- Note: between 1880 and 1940 the US was in effect the world's emerging market, yet equity returns were FLAT when adjusted for inflation over this period

Market truisms



Truism

- Invest in good management

Fact

Fund Manager's best managed stocks (@ January 2010) - as reported in the press	
Stock	YTD to 31 August 2010
Origin Energy	-6.4%
David Jones	-6.4%
Leighton	-17.7%
QBE Insurance Group	-30.6%
BHP Billiton	-13.0%
JB Hi Fi	-5.0%
Toll Holdings	-29.2%
Computershare	-14.7%
Newcrest Mining	5.6%
Woolworths	1.0%
Average	-11.6%
ASX 200	-9.6%

Truism?

- We all can tell the difference between good news, bad news and noise?

Facts

- GM bankruptcy

Dow falls: "Stocks Decline On GM Bankruptcy Fears"

(Forbes, 27 May 2009)

Dow falls: "Rally hopes shelved as the likelihood of bankruptcy for GM shook Wall Street"

(Wall Street Journal, 28 May 2009)

Dow soars: "Stock Market Shrugs Off GM Filing"

(Reuters, 1 June 2009)

- Bond market hardly moved for 3 weeks after Archduke Ferdinand was shot in 1914
 - 1 week later it was closed due to fear of wars and meltdowns
- US Banks were closed by government decree in 1933.
 - the Dow then rallied 4 fold over the next 4 years, it's highest returning period ever
- No significant news in papers prior to 1929 and 1987 crash, so don't look there for guidance (Professor Shiller)

Truism?

- Buy stocks that have done well, as positive momentum is likely to continue

Fact

- over 3 to 5 years
 - Outperformers become underperformers
 - Underperformers become outperformers

Truism?

- High numeracy and academic intelligence guarantee outperformance

Fact

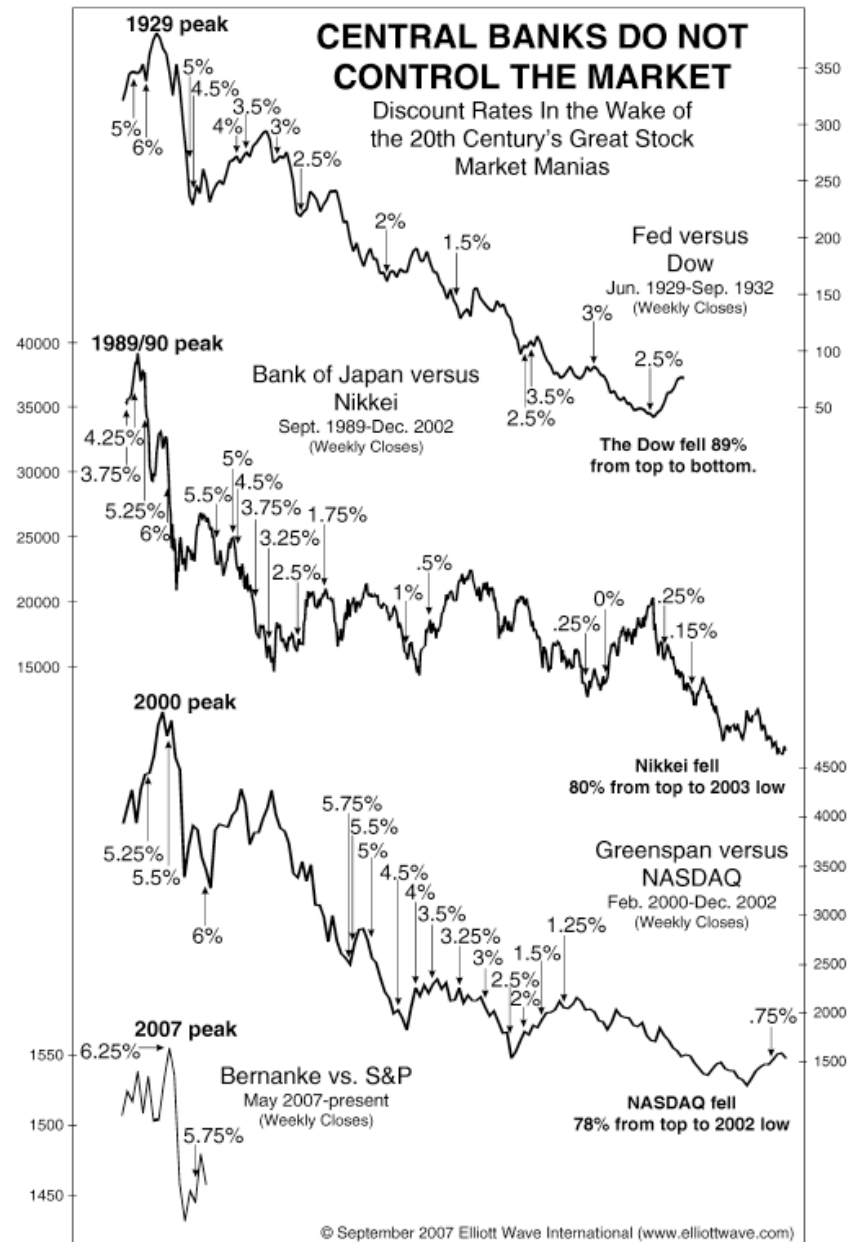
- LTCM became insolvent using models of Nobel laureates
- Enron were “The smartest guys in the room”
- The US senate found that over 91% of the AAA rated mortgage backed securities issued in 2006-2007 have since been downgraded to junk (all were rated using sophisticated quant models)

Market truisms

Truism?

- Don't fight the Fed

Fact



Truism?

- “Short term earnings growth drives stocks?”

Fact

- Generally no correlation between Y on Y changes in earnings and the S&P

(John P Hussman)

- Note: in 2007 earnings looked fantastic and the market subsequently fell 60% over the next 18 months. Then in February 2009, earnings were dreadful, and expected to remain dreadful, yet the market rallied over 50% over the next year
- Since 1932, the Dow has risen over 70% of the time corporate profits have had down years
- Earnings and interest rates drive stocks
 - In 1991 a Goldman’s analyst, Barrie Wigmore, found that only 35% of stock price growth in the 1980s can be attributed to earnings and interest rates

And a final thought...

Bonds versus stocks?



Are bonds safe?

- Bloomberg reports that
 - the amount of cash flowing into bond funds is poised to exceed the cash that went into stock funds during the internet bubble
 - Investors poured USD 480bn into mutual funds that focus on debt in the two years ending June 2010, compared with USD 496bn pumped into equity funds from 1999 to 2000