

# DICK DAVIS DIGEST



**Investment Ideas From The Best Minds On Wall Street**

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## IN PERSPECTIVE

“One of the keys to maximizing profits in the stock market is the ability to be fully invested in Bull Markets and to be more cautious and less fully invested when inevitable Bear markets do arise,” says Jordan Kimmel (The Magnet Investment Group, LLC, is located in Randolph, NJ and may be reached at (973) 895-4444 or via [Jordan@Magnetinvesting.com](mailto:Jordan@Magnetinvesting.com)). “Studies show that 70% of individual stocks follow the direction of the market. During bullish periods indexes do well, those with superior stock selection do significantly better. The great ‘good idea’ companies do better than the ‘mediocres.’ While history shows the overall market is advancing more often than not, *Magnet Theory* indicates that there are times when the market offers better than normal opportunities. This is clearly one of those times – *Phase II of this Bull Market has just begun.*”

“Understanding the life cycle of Bull Markets is paramount if you are to know when to be aggressive and when to be cautious. At the end of a Bear Market, the public is discouraged and the news is terrible. Only those with true long-term conviction, as well as buying power, begin accumulating shares at this time. This first period (or Phase I) of a Bull Market is also a period when institutions begin rebalancing their portfolios, finding themselves with too low of an allocation towards equities as a result of losses. This activity begins the process of turning around the market. During Phase I, the public is hoarding their available cash and their distrust of

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## SPOTLIGHT STOCK: THE INDIA FUND

“Slowdown?” asks Carla Pasternak & Paul Tracy (High-Yield Investing, StreetAuthority, LLC, 1000 Commerce Park Drive, Williamsport, PA 17701, [www.highyieldinvesting.com](http://www.highyieldinvesting.com), (800) 796-8025, 12 issues/12 optional mid-month email updates, \$199, 10/07). “What slowdown? As investors fret that a downturn in the U.S. housing sector could cool global growth, the world’s second-fastest growing major economy after China is forging ahead. India’s Central Statistical Organization reported that the country’s economy expanded at a rapid +9.3% clip during the latest April-June quarter, continuing a +9%-plus growth streak for six of the last seven quarters. That’s more than double the +4% growth rate put in by the U.S. economy during the quarter. It’s no wonder India’s benchmark Bombay Sensex Index is up +19.8% so far this year, well ahead of the S&P 500’s gain of just +7.6%.”

“And the future looks equally strong. Thanks in part to U.S. firms outsourcing their customer service and data processing jobs, India is seeing the rise of a new middle class. Estimated at some 300 million of the billion-plus population, India’s middle class is mushrooming at a rate of about +20% a year. Add to this growth rate the International Monetary Fund’s forecast that wages will increase some +800% over the next four decades. You get the picture. A growing consumer class with an insatiable appetite for everything from houses to TV sets and the money to buy them – the world’s fastest-growing democracy appears to be in the early stages of a major bull market. So how can you tap into

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Wall Street is high. After a period of advance, there is usually a severe shakeout resulting from a 'short-term event' – most recently the sub-prime mortgage fiasco. During this period, the media and the short-term 'newsletter crowd' begin their 'sky is falling' hysteria. This is the precursor to Phase II and is when the public gets a second chance to participate in the advance. Phase II represents simultaneous buying by institutions and the public and begins a period of rapid price advancement.

"Now, at the beginning of Phase II, as the stock market is breaking out to new all-time highs, we are also seeing short interest at a new all high. The 'internals' of the market continue to look great – the advance/decline line is positive and there are only a few number of new lows on the list, following a panic reading of over 1,100 new lows in August. Valuations are the best in 10 years and we have record amounts of cash sitting on the sidelines still waiting 'for a good opportunity.' Billions of dollars of share buy-backs, along with companies being taken private this year, continue to create a floor for an already attractively priced stock market. Corporations are sitting on record amounts of cash as the result of strong operating earnings. But, clearly the scars of the bear market of the early part of this decade have still not fully healed. The attention of the 'wounded' is focused on spotting the top of this cycle. The 'Wall of Worry' is intact. Several factors have come together at one time to power a Bull Market that many continue to bet against. Take a few minutes to consider the implications of the global spreading of the free market that is unfolding before your eyes.

"The global build-out continues unabated and most global markets are even stronger than ours. Cranes are in demand on every continent and shipping rates are at a high. Despite the domestic real estate gloom there may be as many cranes working in New York City as in Shanghai. Through the quantification of *Magnet Theory* by the *Magnet® Stock Selection System* 'good idea' companies managed by great leaders are identified. These companies are fundamentally strongest and provide the most promising opportunities. We are seeing strength in almost every sector that represents a growing global market. *Magnet Theory* holds that while 'mediocres' may gain in value in a bullish environment, individual stock selection is still the key to success in the stock market.

"The *Magnet® Stock Selection Process* is identifying numerous highly ranked companies and many of them are foreign companies. General Electric, along with many of the S&P 500 companies, earns more than half of their profits overseas – why should investors be restrictive with their assets? While Wall Street strategists like to suggest 'a small amount of your investments' should be targeted overseas – we believe money should flow to its most efficient place, the 'good idea' companies, rather than to the 'mediocres' through an asset allocation model. *Magnet Theory* identifies true superlatives, rather than using Modern Portfolio theory that simply over-diversifies a portfolio into the mediocre broad list. With a thorough analysis

of a company's balance sheet we are identifying those companies that have free cash flow and therefore develop 'Free Earnings.' It is the proper use of these free earnings that allows companies to do right by their employees and ultimately their communities at large. At the same time, there are always several examples of companies that are doing poorly. These companies are the ones defaulting on their loans and laying off employees. These, of course, are the ones that capture the media attention and reinforce the public fears that 'there is nothing but problems' in this country.

"There are, and always will be, difficult headlines that prevent investors from thinking and acting long-term. Right now one of the biggest fears is a real estate crash leading to a recession. In reality, the current real estate market represents neither doomsday nor completion for the market. The fears of a real estate led recession, as well as the headlines regarding the 'sub-prime crisis' are greatly overstated. In fact, currently 97% of all residential mortgages are all current. Economic conditions are strong with near full employment. Consumer confidence is improving. While clearly not everybody is getting lifted by the domestic economy, total wealth and investable assets are at a high. U.S. and worldwide exports are also at an all time high.

"Another major concern that is dominating the current headlines is the weak U.S. dollar. While we hear daily about 'all time lows on the dollar,' the information is coming from 'experts' without charts that go back over ten years. And while long-term we would like to see the dollar stabilize, our large multi-national corporations are enjoying the benefits. Net purchases of both our bonds and equities by foreigners continue at a surprisingly brisk pace. Exactly what's the problem?

"We are about to enter a presidential election year, which usually bodes well for the market. Between now and then, we will have an increased emphasis on a strong domestic and global economy, nearly full employment and an interest rate cycle that has already peaked and will become more favorable for the stock market. The time will come when we see buyouts being done with shares rather than cash. When we see that, we will be moving closer to a richly priced stock market. We are just not seeing that yet.

"Warren Buffett did an amazing job in his 2005 annual report of Berkshire Hathaway of supporting the basic premise of *Magnet Theory*. He demonstrated that if the stock market managed the same return from 1999 to 2099 that it achieved from 1899-1999 we would see a Dow 30 of – sit down – over 2 million! It is almost impossible for anybody to think that long-term. *Magnet Theory* suggests that for now, or at least the next 18 months...Enjoy Phase II of this Bull Market!" *Jordan is the President and Portfolio Manager of The Magnet Investment Group, a Registered Investment Advisor, managing private equity funds. This document is for informational purposes only and should not be regarded as a recommendation, an offer to sell, or a solicitation of an offer to buy any securities.*