

No bubble yet, says stocks guru Garzarelli

| BY ASSIF SHAMEEN |

On Nov 18, key US stock indices, the Dow Jones Industrial Average and the Standard & Poor's 500, tore through new record-highs, rising above the milestone levels of 16,000 and 1,800 respectively. At the height of the global financial crisis in March 2009, the Dow plummeted to 6,547 and the S&P to 666. A third Wall Street barometer, the tech-heavy Nasdaq Composite, which hit bottom at 1,108 in October 2002, has been hovering around 4,000, the highest level since the tech bubble burst in March 2000, with the index at 5,132.

Is it time to pour more bubbly and party on, or is it time to cash your chips and run for the hills? One woman who knows a thing or two about bubbles and irrational exuberance says investors should just chill. It is time to sit back, relax and enjoy the ride.

To most investors, the name Elaine Garzarelli brings back memories of the Crash of 1987. Bulls were running amok on Wall Street that year, and valuations were extremely frothy, and the party did not seem like it was going to end anytime soon. As an analyst and money manager for the venerable now-defunct investment bank Shearson Lehman Brothers Inc at the time, Garzarelli was one of the handful of people warning investors that things were getting out of hand. By mid-August 1987, the Dow had touched 2,722 points, or up 44% over eight months from the previous year's closing.

Through much of September 1987, Garzarelli turned more bearish, warning investors to "sell" stocks and build cash positions. On Oct 12 that year, when everybody and their grandma thought stocks were the next tulips, Garzarelli appeared on the *CNN Money Line* programme, saying she believed the market could crash any day. Less than 48 hours later, on Oct 14, the Dow plunged 95.46 points, a record at the time, to 2,412.70, falling another 58 points the following day. On Oct 16, the Dow was down another 108.35 points at 2,246.74 on record volume. What followed was utter mayhem. The global crash began in Asian markets on the morning of "Black Monday" Oct 19, spreading to Europe and, hours later, to Wall Street. That day, the Dow dropped 508 points, or a record 22.61%, to 1,738.74.

The Black Monday crash burnished the image of Garzarelli as a market sage. After her Lehman stint, she was a partner and top executive at several major US brokerage firms until 1995, when she founded her own business, Garzarelli Capital, Inc, of which she is president. In the late 1980s and early 1990s, she was one of the most respected analysts in the US. For 11 years, she was ranked Wall Street's top quantitative analyst by *Institutional Investor*. Although clearly uncomfortable in her role "as a seer with a crystal ball", Garzarelli's views on the twists and turns of the market are still taken seriously by investors.

US market undervalued

With markets soaring and mom-and-pop investors who had shied away from stocks for six years returning to take another punt, does Garzarelli now think the markets are due for another crash or does she think any correction will just be an overdue breather for the bulls to recharge before another rally? "Oh, no, no, no, this isn't anything like 1987 or [the pre-dotcom crash of] 1999 or [the pre-subprime crash of] 2007," she tells *The Edge Singapore* in a phone interview from her New York office. "Actually, I am telling people: If you have any cash, get into the market now. The US stock market is at least 10% undervalued. Right now, there is no bubble in stocks."

Really? So, what does she make of elec-

tric-car maker **Tesla**, whose stock is up 336% over the past year despite a recent sharp 22% correction, or streaming video service firm **Netflix**, whose stock is up 323% despite a 26% correction in recent weeks, or **Amazon.com**, whose stock trades 1,120 times this year's earnings, or **Solar City**, whose stock is up sevenfold this year, or the madness in some recent IPOs such as that of **Twitter**? "Look, you will always have a handful of stocks that trade at bubbly valuations, whether you are in a bull market or a bear market," Garzarelli says. "Are some stocks trading at ridiculous levels? Sure. Is that a sign that we are heading for a 1987-like crash? No." She adds that, in 1999, some months before the tech bubble burst, the price-to-earnings ratio (PER) of the S&P was at 28 times. "In 1987, the PE ratio was only 17.5 times earnings, but you must remember the [US Federal Reserve] was tightening at the time."



Garzarelli: If you have any cash, get into the market now

Garzarelli advises investors to put things in perspective instead of looking at one or two high-flying stocks or one or two market indicators in isolation. She says her years in the market have taught her one thing: Investors need to look at the big picture. For now, Garzarelli is forecasting that earnings for the S&P next year would top US\$105 this year and US\$111 next year. That forecast, she says, is actually 10% below the consensus of US\$121 for next year or PER of 15.9 times. "So, even by my more conservative estimates, the S&P is now 10% undervalued from a historical perspective," she says. If the consensus is right, US stocks on average have more than 20% upside from current levels. "I don't know where you get the idea that we're in some sort of a bubble," she shrugs.

Garzarelli says investors tend to forget that markets eventually move according to fundamentals. "The market may go up or down

every day but, over the longer term, the market's trend is always determined by earnings, interest rates and the Fed's policy," she says. "We could certainly have a correction in the stock market, in part because we haven't had a real correction in nearly two years, but the work that I have done shows any correction would be limited to between 4% and 7% because we are still in a bull market."

She is more realistic about the Fed's tapering of asset purchases, though. "The October employment report was slightly stronger than most people expected, so while it raises the odds of tapering in December, I believe that whether there is tapering next month or in March, the Fed will continue with its quantitative easing programme through all of next year and we are unlikely to see them raising the fed funds rate until some point in 2015," she says. "With the tapering, the Fed is not stopping but very gradually cutting may be

slower growth in some of the emerging markets, but I don't believe that most of emerging markets are about to enter a recession anytime soon," she says. "We believe that, while emerging markets may not be outperformers next year, they will move more or less in line with the US market. Sure, there may be a bit of a pullback in some markets where there are some economic issues, but that's normal for stock markets. Clearly, I don't believe tapering will dent the global recovery or the emerging-markets story."

What about all the stories about mom-and-pop investors from small towns across the US jumping into the market? Isn't that always a great contrarian indicator for savvy investors to get out of the market? "Are the mom-and-pop investors really jumping in?" she asks. "I haven't seen the data, though there was one *Wall Street Journal* story that seemed to suggest increasing retail interest. I actually talked to the president of Schwab Corp, which is one of the big retail brokerages in the US, and he said he isn't yet getting the sense that small retail mom-and-pop investors are jumping in in a big way. It is certainly not happening at Schwab."

No reason to run

"What is happening is that there is some movement out of bond funds into the stock market. But just because some money coming from bonds goes into stocks doesn't mean everyone should get out of stocks and run." Is there irrational exuberance in US stocks? "Even if you have sentiment that is totally and completely bullish and everybody is in the market, you have to see where we are in the economic cycle and look at the monetary policy. You can't just say: Well, everyone's bullish, so that's an indicator that we are at the top and you should sell and sit on your cash."

What would make Garzarelli, who predicted so many bubbles, nervous right now? Would she be worried if the US market went up another 20% and the valuations started to look out of whack as they did in 1999, when the stock market was about 55% overvalued, remember stocks did not crash until the Fed started to tighten," she says. "Valuations are clearly important, but they are just a part of the total mix. You can have valuations run up quite a bit and stocks can remain overvalued for many years if there is low inflation, very easy monetary policy and a Fed that tells you it is not going to raise interest rates in the foreseeable future." That's probably where we are right now, she adds.

So, Garzarelli thinks everything will remain hunky-dory at least for another year or two, and that means investors should pour into markets of recovering economies such as the US. Moreover, she is betting things will not get out of hand soon. For her to be ruffled, she says she would need to see signs of inflation, which she clearly cannot see right now. "Every recession we have ever had over the past 40 or 50 years, except for one, has been in one way or another engineered by the Fed," she says. "You can go back and look at the recessions and you would find that it is the Fed that always creates recessions and bear markets because it starts to tighten monetary policy, which slows the economy and forces investors to flee."

The Fed does what it does because the only way to control inflation is through higher interest rates. "If you look at the situation today, the Fed isn't really worried about inflation at all. If anything, it is worried about deflation now," she says. That, to the veteran stocks sage, is a clear sign that the equities party in the US is unlikely to end soon. **E**

