



Letters to the Editor

November 25, 2008

The following three letters were received in response to our [interview](#) with Jeremy Siegel last week, "Why Equities are Dirt Cheap":

Sirs,

Jeremy Siegel's article of November 18 is a classic example of data mining. The data series available on earnings, dividends and stock prices is so volatile – and non stochastic – that we can make almost any point by choosing our start and end dates carefully. The data is simply not extensive enough or reliable enough to pull conclusions out of the whole set – we have to pick subsets.

Siegel argues that higher dividend payout rates result in lower earnings growth. Specific studies of that assertion have found otherwise (see this [study](#) by Arnott and Asness).

As for periods chosen – if 1981 is the "inflection point" after which persistent low dividend rates chronically induce higher earnings growth, then how do we explain this?

Avg. earnings growth 1961-1981: 2.2%
Avg. earnings growth 1981-2001: -0.78%

Quite the opposite of what Siegel's conjecture would predict.

1921-1981: 3.8% avg. annual earnings growth
1981-present: 3.2% avg. annual earnings growth (and falling)

Again – contrary to the Siegel conjecture.

I could go on and on – as could Prof. Siegel. But, that's the point. We can both cherry-pick data intervals until we're blue in the face and prove nothing.

We can use correlation analysis across the whole data set – but do we compare current-period payout ratios to the next year's earnings growth, or to the next 5-years' earnings growth, or the next 10...? If we torture the data enough and test all plausible constructs and carefully choose our intervals, we can surely find the negative correlation that supports the Siegel conjecture. But that doesn't make it true!



Prof. Siegel uses long-dated data series to make a point (from 1871!), but then projects an earnings trend figure from only 1991, after earlier suggesting that the “inflection point” was 1981. Well, what is the relevant start date: 1871, 1981 or 1991? It seems that the correct start date to assume is whichever one supports the particular point you are making in a particular part of the article.

Finally, Prof. Siegel (mis)uses the calculation of standard deviation in his formulation of earnings expectations. Standard deviation provides meaningful insight into the future expected behavior of a data series if and only if the data series is truly and genuinely random – and time-series earnings data are notoriously serially correlated and are most definitely not random. Earnings results happen for reasons; they are not numbers pulled from a hat.

Also missing from this conjecture is an explanation of how we should rationally expect real per-share earnings growth to persistently rise faster than real GDP. Eventually, corporate earnings will exceed GDP if the conjecture is true. Nonsensical results are enough to kill off the notion out-of-hand.

While I agree with Prof. Siegel that stocks are a good investment for the long run, it strikes me as wildly irresponsible to assert a potential return to stock investors over the next 12 months. How on earth does somebody come up with a return forecast (20% in 12 months!), when stock prices in the near term have rather little to do with earnings and everything to do with investor behavior?

Good article, but it could have used a little more vetting – that’s why academic publications require peer review. But, debate and discussion is good for us all.

I enjoy getting your email newsletters

Cheers,

Rick Ashburn, CFA
Creekside Partners Investment Counsel
Lafayette, CA



Dear Editor,

Last week's interview with Jeremy Siegel on why Stocks are "Dirt Cheap," grabbed my attention. I respect Mr. Siegel, but frankly, I'm tired of hearing "experts" talk about how stocks are cheap. The perma-bulls have been singing the same tune all the way down! And they'll keep singing it until they can't sing anymore--sadly, it's the only song they know. In recent months, I've noticed that some of the loudest singers have gone away. The problem is, if you follow Siegel's advice, you were already fully invested at the top! Now he says stocks are cheap. So what? Too bad his followers don't have any cash to invest.

But, actually, it's worse than that. Siegel has been telling people to buy-and-hold forever and now that their portfolios have been reduced by 30-40% or more, he has the nerve to announce that stocks are cheap. I guess they were expensive last time he told us to buy? Or maybe they were cheap then and now their "dirt cheap." It's really kind of silly, if you think about it. The simple fact is that buy-and-hold investing doesn't work. There are times you want to be invested in stocks and there are times you want to avoid them. In the words of the famous economist, John Maynard Keynes, "Markets can remain irrational longer than you can remain solvent." Sadly, it is this truism that Siegel and so many other experts ignore.

I enjoy your publication, by the way. It's one of the best out there. Keep up the good work.

All the best,

Brian Schreiner
Schreiner Capital Management, Inc.
Exton, PA



Dear Editor,

In your article, *Jeremy Siegel on why Equities are "Dirt Cheap"*, you tolerated Siegel's grossly inaccurate statement, "Shiller uses an historical average of earnings and I use the current value" which for the S&P was 11.7 at the time he wrote his original article.

This is grossly inaccurate, as is unfortunately all too often the case with Siegel. The S&P P/E is a whopping 16.3: using a current value of approximately 750 divided by \$46.13 – the latest 3Q estimate from S&P on Nov 19th. Further he mislabels his extrapolation as "current," but he doesn't get the correct quarterly figure, which is only \$9.91, not \$23 as he claims.

The problem may be because Siegel is using operating earnings, which have been tracked by S&P for only 21 years. They have no meaningful history and are notoriously overstated, especially bottom-up calculations. The numbers I am using are GAAP as-reported numbers.

And since when can anyone get a valid annual figure by simply multiplying by four when individual quarterly earnings are so cyclical and relatively disproportional because of business cycle seasonally?!

His gross data errors and simple-minded reasoning are misleading your readers.

Respectfully,

Bob Bronson
Bronson Capital Markets Research
Denver, CO



The following letter is in response to the [article](#) "Out of the Red: Russian Markets Poised for Recovery":

Dear Editor,

Is the massive sell-off of Russian equities due to the Georgian conflict, lower oil prices, and inflation? Or is it due more to lost confidence in the markets due to Putin and others moving against the Oligarchs and turning public corporations into government owned entities?

If it is due to the latter, then low valuations are irrelevant. Fear of increased government control is the issue. Until there is increased confidence, or until perceived risk parameters lessen I question the validity of moving into the Russian markets even if the fundamentals scream loudly that the opportunity is now.

Don Wilber
Merrill Lynch
Juniper, FL

www.advisorperspectives.com

For a free subscription to the Advisor Perspectives newsletter, visit:
<http://www.advisorperspectives.com/subscribers/subscribe.php>