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Subject: Michael B. O'Higgins, Beating the Dow with Bonds

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Call It Two Decision Investing

By Scott Burns

"The common belief is that the monetary authorities are in control. If that was true--- that governments can control economies--- then we'd all be borrowing from the Russians."

As if this one example isn't telling enough, Michael B.O'Higgins draws a breath. "And what have you heard lately about 'Japan, Inc.'?"

The visitor in my office is the progenitor of a virtual industry, the Dow Dogs. In case you've never heard of it, the Dow Dogs is a simple investment idea with a rabid following.

It works like this. Take the 30 stocks of the Dow Jones Industrial Average; eliminate all but the 10 with the highest dividend yields; then pick the five with the lowest price per share. Next year, do it again. No computer. No MBA. No staff of eager researchers. Just a simple idea--- big companies survive and pay good dividends while you wait.

The technique has a track record most money managers

would envy.

That isn't, however, what Mr. O'Higgins is visiting about.

He's here to talk about his new book, "Beating the Dow with Bonds" (Harper-Business, \$24.00) because he believes there is a limit to how much you should pay for stocks. He also believes we have passed that limit.

"Since 1980 I've mostly been in zeros", he says, referring to zero coupon U.S. Treasury obligations." I can see us comfortably going to 4 percent on long bonds by the year 2000. That's where we were in the early 60's. That's when we had low inflation."

This is not a minor change. If yields on long zeros fall from 5 to 4 percent over the next two years, he figures, the investment will return 20 percent each year, most of it from appreciation.

"Last year gold was down slightly. Recently it's been hit pretty hard. Support has been around \$300 an ounce for twenty years. But it's breaking down. It seems to be saying that the efforts of central governments (to reflate) aren't working. You can see the same thing in the Commodities Research Bureau Index. If we were going to have inflation then commodity prices would be signaling it by starting to go up. Instead, they're going to new lows.

"Gold has accurately forecast the course of long interest rates in 29 of the last 30 years. I don't know of a single economist with a record that comes close to that."

Gold, which few seem concerned about these days, is important to Mr. Higgins because his new book has two simple rules for telling where to invest your money.

The rules go like this:

1. If the earnings yield (earnings divided by price)

- of the S&P 500 is greater than the yield on a 10 year Treasury plus about 0.30 percent, invest in the Dow Dogs. If the earnings yield of the S&P 500 is less than the yield on a 10 year Treasury (as it is now), invest in fixed income Treasuries.
2. If the price of gold has risen in the last year, buy Treasury bills; if the price of gold has declined in the preceding year, buy long term Treasury bonds. Since gold has fallen in price over the last year, the signal is to buy bonds.

In other words, two rules tell you to either be 100 percent in Dow Dogs, 100 percent in long bonds, or 100 percent in cash equivalents. I asked Mr. O'Higgins if a less radical approach was possible.

"It's not my style." He said.

"From 1968 through 1998 the stock market has had six losing years. The Dow Dogs have had four down years. But using this approach--- which you can do in a few minutes with statistics from Barron's--- you would have had only one losing year. That was 1974, a loss of 3.8 percent, when the method got you into stocks a year too early.

"It's more volatile... but the volatility has been up."

The book shows the method producing a 23.77 percent annual return from 1969 to the present, handily exceeding the 18.03 percent return of the Dow Dogs which, in turn, blew away the return on the S&P 500. And, yes, the return on the S&P 500 blew away the vast majority of money managers.

Should you invest by O'Higgins' rules?

Probably not. Most people won't have the stomach for such radical shifts in their investments.

Then why am I telling you about him? Just this: Another long-term investor is looking at stocks, finding them

overvalued, and giving a signal to sell them all.

The rest of us may want to lighten up a bit and throw a little red meat to the bulls.

Questions about personal finance and investments may be sent to: Scott Burns, The Dallas Morning News, P.O. Box 655237, Dallas 75265; or faxed to (214)-977-8776; e-mail to scott@scottburns.com Check the website: "www.scottburns.com." Questions of general interest will be answered in future columns.

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