"Three Generals" May Lead the Market Higher

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"Three Generals" May Lead the Market Higher

By Jim Pearce (bio at end)
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When I started out as a stockbroker 35 years ago, my manager told me that I could never go wrong recommending the "three generals" to my clients: General Motors (NYSE: GM), General Electric (NYSE: GE), and General Mills (NYSE: GIS).

Back then, each one of these companies was considered an industry leader that was impervious to the ebbs and flows of economic cycles. For a long time, that was true.

From 1984 thru 1999:

- GE delivered a 3,000% total return (appreciation plus dividends) to its shareholders;
- General Mills gained 1,000%;
- General Motors eked out only a modest gain but paid a big dividend that kept shareholders happy.

However, all of them have since fallen on hard times.
General Motors had to declare bankruptcy and start anew eight years ago;
General Electric has lost more than half its value over the past two years; and
General Mills is down more than 40% over the same time-frame.

But lately, the three generals are showing signs of renewed life.

Over the past 10 weeks, General Motors has risen nearly 30%. General Mills has jumped 8% during the past six weeks, and GE has bounced off of its post-dividend cancellation lows from two months ago.

That is a small sample size but it is worth noting given the stock market's subtle shift away from overpriced momentum stocks and towards value.

Changing of the Guard

Just as the so-called FANG quartet of "new tech" giants Facebook (NSDQ: FB), Amazon (NSDQ: AMZN), Netflix (NSDQ: NFLX), and Google (NSDQ: GOOG) have led the stock market to record highs since the Great Recession, it may be stocks like the three generals that keep it there.

One argument in favor of an impending stock market correction is the inflated value of many stocks based on their forward price-to-earnings ratio (FPER). Currently, the FPER for the S&P 500 is about 17 times next year's profits, nearly 20% above its long-term average. However, the average FPER for the three generals is only 14 times future earnings, below the index average.

What that means is that the three generals could appreciate in value at the same time the rest of the stock market is dropping if enough investors simply transfer money from overvalued momentum stocks into value plays like these.

Yes, that is an unconventional theory that is not getting much airplay from the mainstream financial media outlets. But, if the Fed ends up having to raise interest rates faster than expected, or a full-blown trade war breaks out between the U.S.A. and the rest of the world, do not be surprised to see investors scrambling to shift into cheaper stocks like these.

Until that happens, this may be an opportune time to begin accumulating low-multiple stocks that have bottomed out and are in the early stages of recovery. They are not hard to find, but they are hard to see. That is because you will not hear the talking heads on television extolling their virtues until the transition is well underway.

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Jim Pearce is the Chief Investment Strategist of *Personal Finance*, our flagship publication. He is also the Director of Research at Investing Daily, overseeing the work of our entire analyst team. He began his career as a stockbroker in 1983 and over the years has managed client investment portfolios for major banks, brokerage firms and investment advisors. Jim has a BA in Business Management from The College of William & Mary, and a CFP from the College for Financial Planning.