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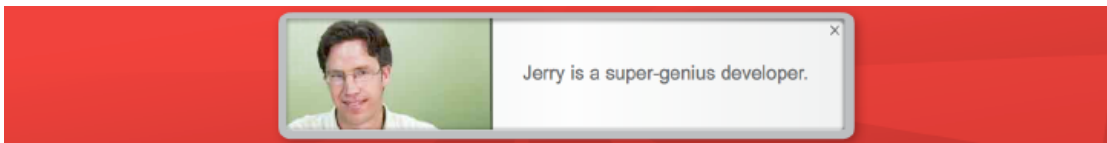
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SATURDAY, DECEMBER 6, 2008

INTERVIEW

A Leading Bear Turns Bullish, Sort of

Barry Ritholtz, CEO and Director of Equity Research, FusionIQ

By **ROBIN GOLDWYN BLUMENTHAL**

AN INTERVIEW WITH BARRY RITHOLTZ: Getting ready for a "significant" rally.

FOR THE PAST FIVE YEARS, BARRY RITHOLTZ HAS BEEN entertaining, educating and elucidating readers of his blog, The Big Picture (<http://bigpicture.typepad.com/>). Among the noteworthy calls that the savvy lawyer and sometime-trader has made: identifying a credit bubble a few years ago, and a recommendation to short AIG back in February, when the share price was flirting with \$80; it's now about \$1.80.



Chris Casaburi for Barron's

"There's upside here for a trade. Over the past 100 years, we've only seen the relative strength of the S&P 500 drop to this level five times...Each time, it has been a major buying opportunity, although not necessarily a major bottom." —Barry Ritholtz

Lately, the 47-year-old Ritholtz, with his business partner, Kevin Lane, has had a chance to put some of those ideas to work at FusionIQ, a firm that manages nearly \$100 million in separate accounts. Amid the wholesale destruction on Wall Street, Fusion has produced single-digit gains on its long-short portfolios, and has kept the average losses on its long-only accounts to single digits. Ritholtz, whose book *Bailout Nation* is due early next year from McGraw-Hill, can be trusted to call 'em as he sees 'em. To find out what the contrarian is now warming up to, read on.

Barron's: *What's your global outlook?*

Ritholtz: In 2006, I was probably the most bearish guy on the Street; now at a table of industry people, I'm the bullish guy. We've cut this market in half; that doesn't mean it can't go lower. We're in a medium recession. If this turns into a deeper, more prolonged recession, all bets are off.

Are we are testing a real low here?

There's no doubt we're looking at an extremely oversold market. But by the end of the week, that oversold condition could be worked off. There's upside here for a trade. Over the past 100 years, we've only seen the relative strength of the S&P 500 drop to this level five times, and each time, it has been a major buying opportunity, although not necessarily a major bottom. If you look at 1929, it was a low but it wasn't the low, and there was a bounce. It was the same thing after Sept. 11 -- from Sept. 21, you had a 40% bounce in the Nasdaq before you went down to make all-time lows.

Will the market drift?

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It's flapping up and down. There is a significant rally, 20% or 30%, waiting to happen. But there's also the possibility of a lower low, as we get deeper into the recession, if things take a terrible turn for the worse.

Whenever you're fragile, you don't have the ability to absorb that next blow. My fear is that some economic issue arises and you don't have the resiliency to deal with it. We're economically stretched very, very thin. Things seem to be getting healthier at an ungodly cost, one which we will be dealing with the unintended consequences of for decades. We're really at the fork in the road. Everybody on Wall Street is wondering if we're going to see a year-end rally of any substance, or, if we're heading down to 7100 on the Dow, or 850 on the Nasdaq. [On Friday, those indexes were at about 8200 and about 1430, respectively.]

What say you?

We're waiting for a couple more things to line up: Some clarity on earnings, which we won't have for a while, some sort of resolution on these bailouts, and some sign from the new administration that, unlike the outgoing group, we have a plan -- "Here's what we're going to do about credit, banks, the economy, GM." We wouldn't be surprised to see earnings seriously damaged.

Wall Street is still way too high. They started out the year at earnings of \$103 a share on the S&P 500 for 2008, which got them to 1600 on the index. We came in at \$65 a share, and that may have been too bullish. The good news is that most of corporate America outside of the financial sector has healthy balance sheets, lots of cash, and is running very lean.

Except for the auto industry.

The auto industry is a whole other story. The auto industry is a story of terrible management, misguided unions, and government intervention.

What's your impression of the bank bailout?

[Treasury Secretary] Hank Paulson is really the imperfect messenger for this bailout. Remember that Paulson is one of the five executives who went to the SEC in 2004 to beg, 'Please, let us lever up more. Please let us go to [a leverage ratio of] 30 or 40.' It is bad enough that he helped create the crisis. It appears that this whole response is completely ad hoc.

Do you see any guiding principle?

It is, how do you give money to banks who need capital and not say, 'By the way, you're cutting your dividend.' What's happening instead is they're saying, 'Here is money: Give it out as dividends and bonuses.' It is unbelievable. There is no clawback. It is unconscionable.

So, what does it take to invest in this kind of world? How do you stay out of trouble?

We have a number of internal rules. The most important is that we always have a stop-loss. When the trade is working out, we use trailing stop-loss, meaning that the higher the stock goes, the higher the stop-loss. When the market starts heading south, we get taken out. We screen for short squeezes, and we've found that they're very often present at the beginning of a major move up.

We back-tested [price/earnings ratios] and found they have no forecasting ability. Whenever people do an analysis of a stock, the tendency is to create a snapshot at a given moment. We try to build a moving picture of a stock. For instance, if you know you're in an all-time peak in home sales, and the Fed is in a tightening regime, why own a stock in a homebuilder?

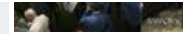
The builders have been pretty beaten down, though.

I've been the biggest bear on housing on the Street for four years now. Housing is halfway through. We're not even close to the bottom in housing. The stocks were always cheap, so it's not a valuation question.

Given the uncertainty in the market at large, what appeals to you right now?

We've been trading the two-to-one leveraged [exchange-traded funds].

One is the [Ultra S&P ProShares](#) [ticker: SSO] -- for every dollar the Standard & Poor's 500 moves, it moves two dollars. And there's also [Ultra Triple Q ProShares](#) [QLD], the Nasdaq 100-version of the SSO. The flip of the QLDs are the QIDs, which are the negative two-for-ones on the Nasdaq. We're



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starting to look at that. We are now running about 70% cash, which is inordinately high, but some of the names we're watching, and have owned in the past, are [NuVasive](#) [NUVA], a medical-device company, [Stanley Works](#) [SWK], a great infrastructure story, [LG Display](#) [LPL] and [Luminex](#) [LMNX]. Industries we like are infrastructure, defense, biotech and medical devices.

Why ETFs?

We're normally bottom-up stockpickers. But when we're looking at all these individual stocks and war-game them, we end up saying there's this risk and that risk. Here's an example: [JPMorgan](#) [JPM] is probably the best house in a bad neighborhood. It had a nice run, then it pulled back; do we want to own JP Morgan? What's the risk? They've already acquired Bear Stearns. They have to be looking at [Goldman Sachs](#) [GS]. They have to be looking at putting the house of Morgan back together. If that happens, what happens to the stock price of JPMorgan? You could lose 15%, 20% overnight. Every time we look at individual stocks, we end up with that analysis.

We spent a lot of the year running a good chunk of cash. Some of that is discipline; a lot of that is staying away from things that are really trouble. The trade that caused so much trouble for people -- long financials -- we're at the point where some of the financials are starting to look attractive.

Would you give us a name?

[Citigroup](#) [C] at \$5. The interesting thing about Citigroup is that if there's anything that's legitimately too big to fail, Citigroup is it. If you think the consumer and retail sector are having a hard time, imagine if Citigroup were allowed to go belly-up. People would hunker down in their homes and stop buying all but the necessities.

I didn't really buy that Bear Stearns was too big to fail, although there was the argument that they could take JPMorgan down. Citibank is one of those things that cannot be allowed to go belly-up. It's enormous. It's the equivalent of AIG.

What else do you like?

We like infrastructure, plays like Stanley Works, and we expect there will be some stimulus to build ports, bridges, and expand the electrical grid. Defense is another sector we like, though it's less so of the [Boeing](#) s [BA] and more of the specialty-defense names, like [AeroVironment](#) [AVAV], which makes small, pilotless drones.

There's a list of interesting biotech and medical-devices companies, which are insulated from the economic cycle. We just bought [Cubist Pharmaceuticals](#) [CBST], which addresses the anti-infective market. In the same way the Internet bubble gave rise to Web 2.0, Facebook and blogs, the Genentechs of the world and all the developments that took place throughout the 1990s have led to the current new wave of specialized therapeutics. Over the next 10 years, we're going to see a universe of breakthroughs based on the previous 20 years' work. The first order of business on Jan. 20 [presidential-inauguration day] is allowing stem-cell research, and that's going to lead to a number of significant breakthroughs. Medical devices and gene therapies are ripe areas. The problem is, they're very volatile and very speculative, and not necessarily safe for the ordinary household.

What stocks are you shorting?

We've been short [Jefferies & Co.](#) [JEF] for a while. They're similar to the various asset gatherers: In this environment, it becomes very challenging to hold on to key people. The best guess is, they're suffering along with the rest of the sector, only they don't have the strength or the size to do things that a Goldman Sachs or a Morgan Stanley or Wachovia can.

What about gold?

Table: Ritholtz's Picks
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Gold is really quite interesting here, as are the gold miners.

We own no gold now, and we own no gold mines, but we are watching them. The question is, at what point does this deflationary cycle roll over to the point where things start to get better?

We were among the loudest inflation hawks for the past few years. When oil was \$147 a barrel the joke was, which was going to hit \$6 a gallon first, premium gasoline or skim milk?

In March, we said we are through the worst part of the inflation cycle and now we should see deflation as the economy starts to roll over. And that is pretty much playing out. The bugaboo with all that is you

just had the Fed triple its balance sheet. The Bernanke printing presses are running full speed. That ultimately has to hurt the U.S. dollar; it ultimately has to be inflationary.

Has gold bottomed?

I don't know where gold bottoms. We recommended gold for the first time in 2002 or 2003. It was strictly an inflation trade, thanks to Greenspan. And then when the **GLD** gold ETF first came out, we recommended that. Gold has a date with \$1,500 somewhere in the future [up from \$763 an ounce now], but whether it makes that move from 700 or from 400, I have no idea. You just can't print that much paper and debase the currency and not see some sort of reaction.

Anything else look interesting?

We always tell people when things are really good you have to make emergency plans. You know, the time to read that card on the seatback in front of you is not when the plane is heading down. When things are really awful like they are now, that's when you start making your wish list. I have never owned [Berkshire Hathaway](#) [BRK], but if it was cheap enough I'd buy it.

A level, please?

\$85,000 to \$95,000 [versus \$98,000 recently].

Where else might you be deploying some of that cash?

One client said to me, "I'm tired of hearing bad news. I don't care what it is, what can you tell me that is good?" I told him to make a list of things he's wanted to own, but has been afraid to buy or unable to because of the cost. I don't care if it is art, trophy properties, vacation homes, collectible automobiles or boats. Figure out what you are willing to pay, and I can all but guarantee you that by the time we are done with this deflationary cycle, many of those objects will be available at your price. I wouldn't be surprised if, when everything is said and done, a lot of these things are off by 50% or worse.

Thanks, Barry.

E-mail comments to mail@barrons.com

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