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The Future for Investors

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Ben Bernanke's Favorite Stock

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If you found out that Warren Buffett, Peter Lynch, or Alan Greenspan held only one stock in their personal portfolio, chances are you'd want to know what it was. So when I learned that Ben Bernanke, who is likely to succeed Alan Greenspan in the world's most powerful economic policymaking post, held only one stock, I found that newsworthy.

Bernanke held stock of a company that evokes strong feelings -- both pro and con -- among investors. That company is Altria Group, formerly Philip Morris, one the world's largest manufacturers of cigarettes.

A Remarkable Record

You may say that being nominated Fed chair does not imply any special investment savvy by its nominee. That may be true, but Mr. Bernanke, a superb economist, knows a good deal when he sees it. In fact, according to my research, Philip Morris has offered better long-term returns to its stockholders than any other stock, nearly doubling the returns on the market over the last half century and crushing the performance of virtually every other mutual fund and active money manager. Let the facts speak for themselves.

For all companies trading 80 years ago in 1925, when our comprehensive returns on individual stocks begin, the company's average annual returns exceed 17 percent per year versus 10 percent for the market, surpassing all other stocks.

From 1957, when the S&P 500 Index was founded, Phillip Morris has yielded nearly 20 percent per year, outclassing the other 499 members of this venerable index by wide margins.

To give you an idea how strong this performance is, if you put $1,000 in an index fund when the S&P 500 Index was founded and reinvested your dividends, you would have about $140,000 today. But if you put $1,000 in Philip Morris stock, you would have over $6 *million* dollars today -- more than 40 times as much!

Why did Big Mo (as traders affectionately call Philip Morris because of its ticker symbol "MO") do so well? For a simple reason, there are millions of investors out there who won't touch this stock with a 10-foot pole. And that keeps its price down and its returns high.

I'm not criticizing investors who won't buy Philip Morris stock on moral grounds. I abhor smoking, believe it is a leading cause of death, and grant that threats of litigation and legal liabilities plague the company.

Furthermore, the trends for its primary products are bad: The number of cigarette smokers has steadily declined in the U.S. over the past decade and will soon do so in the rest of the world.

But these fears are precisely the reason Philip Morris has done so well for those that stuck with the stock. Everyone worried so much about this company that its stock often traded at ridiculously low prices. And, the company continued to churn out profits and pay investors most of its earnings in the form of dividends. Its low price and high payouts mean the stock's dividend yield has been extraordinarily high. Since 1992 the average dividend yield of Phillip Morris has been 5.2 percent, versus only 1.9 percent for the S&P 500 Index.

Ups and Downs

Philip Morris zoomed in popularity in the late 1950s by making Marlboro cigarettes, one of the world's most successful brands. But with rising health concerns, the company decided to diversify and purchased General Foods in 1985 and Kraft in 1988. With these acquisitions, Philip Morris achieved an astounding annual return: 22 percent per year from 1957 through 1992.

But the good times did not continue to roll for the cigarette manufacturer. First, MO was hit with competition from generic brands. As a result, the company slashed the price of Marlboros by 40 cents a pack on Friday, April 2, 1993. This shocked the investment community and sent the stock plunging 23 percent on the same day. The day became known as "Marlboro Friday."

But it was not competition from generic brands that disturbed investors the most. Lawsuits from individuals mounted and finally states sued the cigarette industry to recover health expenses. Philip Morris was required to pay over $100 billion in settlements.

Dividends Are the Key

It is an irony that long-term holders of Philip Morris stock may have done *better* as a result of these penalties than they would have without them.

How is that possible? As long as Phillip Morris still paid a dividend, and the company to this day has never lowered its dividend, investors were able to buy a much larger number of shares than if the price had not been depressed. Eventually the value of the increased number of shares surpassed the value that would have accumulated had the shares never fallen in price.

Philip Morris also disproves the oft-heard Wall Street assertion that fast-growing firms should not pay dividends. MO managed to grow (in fact, the company delivered some of the highest earnings growth rates I've found in my studies) and still pay a hefty dividend check to shareholders. Today Phillip Morris pays 60 percent of its earnings as dividends, almost twice the average for the S&P 500 Index.

Today, as the clouds of litigation clear, the price of Philip Morris stock has rebounded and its dividend yield has fallen to 4 percent. The company claims -- and many analysts agree -- that it can increase shareholder value by breaking up its holdings and selling individual sectors so that the value of its non-cigarette holdings will not be tainted by future tobacco litigation.

Whatever happens to Philip Morris, its past performance has provided critical lessons to investors about the qualities of a good long-term investment. If Ben Bernanke's Fed policymaking matches the success of the only individual stock he holds, our nation's economy could not be in better hands.