

# An unreality show

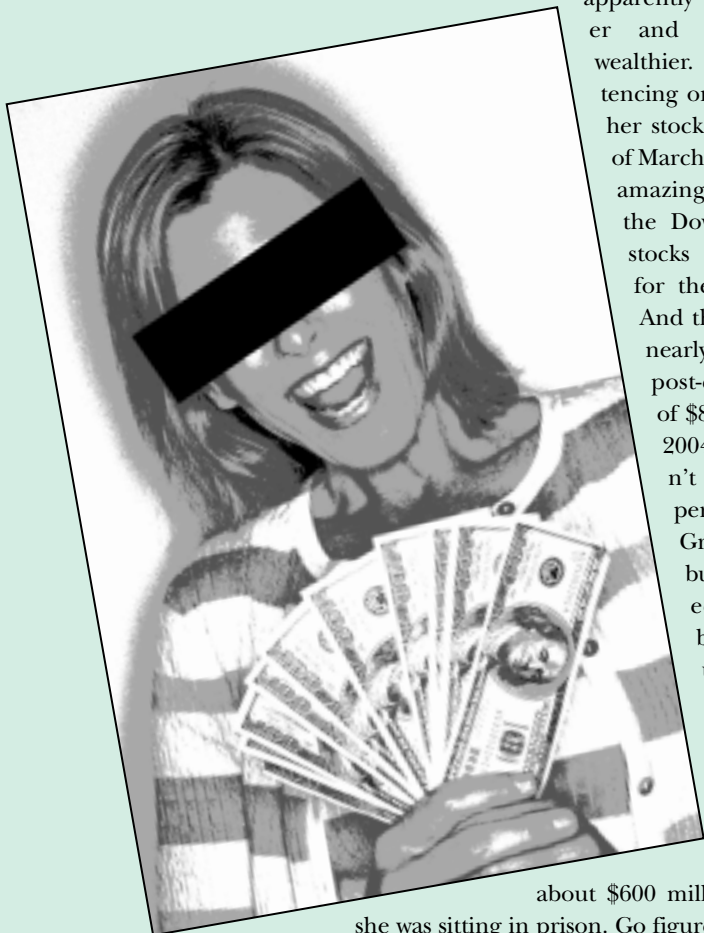
**T**he term “Go figure” fascinates me. It’s that handy catch phrase we use when something happens that’s not what we expect and we’re stumped to explain it.

Martha Stewart is a case in point. She left prison

apparently thinner, happier and yes, certainly wealthier. Since her sentencing on July 16, 2004, her stock rose 170% (as of March 3, 2005). Pretty amazing compared to the Dow Jones media stocks index up 10% for the same period. And the stock was up nearly 300% since its post-conviction low of \$8.55 on May 19, 2004. Stewart didn’t receive a salary, per se, while in the Greybar Hotel, but her employee and other benefits continued and, given that she owns more than 29 million shares of her stock, her stock gains were

about \$600 million – all while she was sitting in prison. Go figure.

So what’s behind the stock and the star? Clearly an example of a momentum stock; individual investors are buying on emotions not fundamentals. It’s hard to justify the current stock price. Revenue continues to plunge, and those in the know don’t expect any real profits for at least two years. It’s interesting that the company has a market value of \$1.7 billion (number of shares times price per share), but we can’t use the rational yardstick of P/E ratio because the company doesn’t make any money. It is expected to lose 48 cents a share this year according to analysts polled by Thompson Financial and may squeeze out 4 cents a share in profits in 2006.



So if we can’t use revenue, P/E ratio or profit to value the stock, what about cash flow, a metric used by many money managers and investors? You guessed it – *Martha Stewart Living* has negative cash flow too. Let’s suppose it returned to the peak cash flow it had in 2001, it would trade below \$20/share, very different from its mid-\$30s value in early March. MSO announced a record loss of \$60 million in 2004, nearly 10 times the loss it suffered in 2003, yet at the same time, giddy investors pushed the stock to a five-year high.

Obviously hype and hope are driving the stock price of MSO. Stewart’s re-entry into the world is a picture perfect study in good PR and a boost for investors, employees and supporters. Her revival recipe includes two TV shows (one like “The Apprentice”), an increase in mechanizing, publishing, ads and internet and direct commerce.

It may well be that prison time has been one of the best moves in Martha’s career. Clearly not something you’d like to point out to your children. The stock surge is baffling analysts who see almost no hope that the company can grow earnings fast enough to support the current stock price. Some analysts are valuing the existing businesses below \$10/share, based on future expectations for the publishing division. From every perspective, the stock price has its own unreality show. Yet, even downright pessimists acknowledge that there’s little chance of a sell-off in coming weeks.

What are the lessons from Martha’s story? Realize that investors are eternal optimists, but don’t let hype drive your investment decisions. Recognize that the perceived value of a stock or company can be greater (or less) than what the fundamentals tell us. Diversify your holdings to limit the pain when a favorite stock (or the market) declines. If one stock in your portfolio outperforms others in the same industry, find out why. If a stock is trading at a peak and you don’t see much upside, consider taking some profits now. Do everything you can to protect against losses and then “go figure.” ♦

Victoria Collins, Ph.D., CFP is named among the USA’s 100 Best Wealth Managers by Robb Report/Worth Magazine. A principal with The Keller Group, her office is in Irvine. Contact her at [vcollins@kellerinvest.com](mailto:vcollins@kellerinvest.com).