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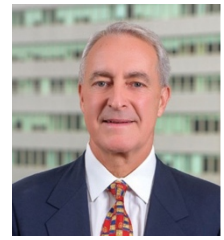
Thoughts for Investors



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"There is nothing as deceptive as an obvious fact."
– Sherlock Holmes

<u>This Time Is Different</u>,

The stock market continues its historic volatility, and investors rush to the safety of Treasury bills earning 0% interest. Few investments seem safe, few retirement nest eggs are unscathed, and few companies seem immune from the potential (even if it is remote) for bankruptcy. The prevailing opinion from Wall Street veterans, government officials, and investors is that "this time is different" and now is certainly no time to be taking risks by investing. Today's economic, political, and social problems are too deep, universal, and unique. Yet, is it really different this time? Students of history will find that, surprisingly, many of today's issues are similar to those of the past (obviously with new twists added as mankind "advances"). Does anyone really think greed, corruption, fear, or bad judgment are unique to our time? It is the people involved who are different. It is not called the "Madoff scheme" because it has happened before. Charles Ponzi did it long ago and I would daresay he didn't invent it either.

"Nothing in life is to be feared. It is only to be understood."
– Marie Curie

What did John Templeton mean to teach us by his famous admonition, "This time is different are the four costliest words in investment history"? How did he and other great investors such as Fisher, Buffett, or Graham happen to be successful in light of trying times throughout history? Undoubtedly, they heard "this time is different" uttered in their day yet invested anyway. Fundamental, technical, or quantitative stock analysis was not their secret. If any or all of these methods were the sole basis for success a formula would have been discovered by now. Nor did their success lay in acquiring inside information, skirting regulators and rules – or leverage. Rather, I believe the success of the great investors came from a combination of doing the analysis (of course) and more importantly, understanding and capitalizing on the emotion of investors. Better than most, they understood that while the cast of investors during rising or falling markets often changes, investor actions are somewhat uniform, maybe even predictable. Investor emotions tend to cycle, over time, between the extremes of fear and greed. (As one of my clients has correctly pointed out, if emotions are cyclical, then investors really go from fear of losing, to fear of missing out and back to fear of losing again). No wonder it's so hard for people to be happy! Emotion leads humans to extraordinary feats both good and bad. Emotion can enable a human to lift a car and save a person or it can cause one person to kill another out of anger or passion. Emotion can cause one 60-year-old investor to be calm about a market decline while another 60-year-old investor is worried to the point of sickness. Sometimes their net worth is not even a clue as to which one is which. Though science will continue to examine the role other factors may play, emotions are still credited with driving much of human activity. I have often reminded investors that I believe emotions are the primary driver of stock prices (or the price of any investment). One needs to look no further than the price of art to realize this. Have you ever marveled at the multi-million-dollar prices of some ridiculous looking modern art? Sometimes emotions are positive and prices rise, sometimes they are negative and prices fall.

"To succeed, jump as quickly at opportunities as you do at conclusions."

– Benjamin Franklin

The great investors knew that "this time" is not that different from other times in history with respect to human emotional response; and their success came from learning to harness that understanding. Like waves, investment cycles come and go and vary in their length and intensity. The greatest opportunities, like great waves, come infrequently and don't look like much – at first. Unfortunately, the reality is that many investors wait so long that the wave has usually crested, and indeed is about to crash, before they invest. In retrospect most recently, prices were already peaking by the time many individuals or pension plans, endowments, and foundations were getting interested or invested in commodity mutual funds and ETFs, or "alternative investments". Of course the consultants, financial planners, and "fund of funds" advisors, (the "investor helpers" as Jack Bogle calls them), fed investor's egos and/or appetites by giving them what they wanted. Alas commodities, real estate, alternative investments, and other waves, have peaked and crashed - and many investors are "under water."

"Great minds discuss ideas, average minds discuss events"

– Hyman Rickover, Admiral, US Navy

In summary, in the cycle of investing, the wave of greed (or fear of missing out) has peaked and crashed, and the wave of fear (of losing) is upon us. Some investors see fear as peaking, while others are certain it is just forming and have panicked and sold. Still others, overextended through leverage and use of credit, have been forced to sell. Many investors are "sitting on the sidelines", acknowledging they will probably miss the bottom because they are waiting for some "event" to prove that the recovery is "real". I suggest that by the time they are "ready", they will be unknowingly perched on the wave of greed and about to crash. I admit no one knows the market bottom (or top) until after the fact, since no signal is ever given to investors. Yet history does provide clues and the great investors have told us how to interpret the clues. The time to invest (or not invest), the great investors would say, is at the extremes of human emotion – fear and greed; the more extreme the fear, the greater the potential reward (yet the more patience that is required - as I have written previously). John Templeton advised us to "buy when others are despondently selling" and that "bull markets are born on pessimism…and die on euphoria." Warren Buffett taught us to "be greedy (buy) when others are fearful." Even James Madison, 4th President of the United States, observed the influence of emotion on investors when he said, "the circulation of confidence is more important than the circulation of money." Perhaps the most profitable observation on when to invest comes from the great investor Shelby Cullom Davis. Davis, who built a $100,000 investment in common stocks into $800 million, observed in hindsight, "I made most of my money in bear markets. I just didn't realize it at the time." Many investors have heard these words of wisdom before and often nod in agreement. Yet many still choose either inaction or to follow the herd because emotion tells them "this time is different." I believe Templeton was trying to teach us how to be effective investors. Not investing today because "this time is different" will once again be proven, as it was proven in his day and many times before, "the four costliest words in investment history".

"When one door closes another door opens; but we so often look so long and so regretfully upon the closed door, that we do not see the ones which open for us."

– Alexander Graham Bell

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Hear the Other Side

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If you would like to discuss the topic of this newsletter, or our team's approach to investing, please feel free to contact us by email at al.boris@alexbrown.com.

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