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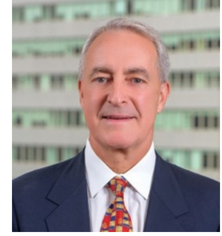
Thoughts for Investors



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Cardinal Rules - Stick To Your Game

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"You may delay, but time will not."

– Benjamin Franklin

It is certainly an understatement to say that these are challenging times for investors—and the advisors who help them. Gone are the days when buying a stock index investment or redoing the pie-chart of your asset allocation assured success. Even bond investors are nervous as they face credit quality concerns, price volatility and declining income due to interest rate reductions. During these stormy times, investors need to possess and use certain basic skills to give themselves a better chance of success. In this Thoughts for Investors I will outline some of those basics.

"This time it's different' are the four costliest words in investment history."

– John Templeton

Accept the reality of the current conditions. We all would rather invest only on sunny days. If you have a massive amount of assets and concurrently, appropriate spending habits, you may be able to choose not to invest in the stock market. For most investors though, retirement, high income needs or even the desire to leave a legacy to heirs or charity demands that they invest in the stock market - rain or shine. No one knows when this current crisis will end. Yet investors must guard against believing that the sun will never return because "this time it's different."

"Be fearful when others are greedy and greedy when others are fearful."

– Warren Buffett

- Remember the first "cardinal rule of investing" - for every buyer there must be a seller and for every seller there must be a buyer - and you had better know what is motivating that other person.

During a home purchase, your agent may be able to quite easily learn that the current owner has just been transferred by their employer and is therefore a motivated seller. Buyers and sellers of stocks never meet face-to-face and therefore it is very difficult to know exactly what the other person is thinking (or knows). Yet both face the same market conditions, and because of the media's use of terms such as "meltdown" or "collapse," I conclude that emotion is playing a role in seller's decisions. When an investor becomes singularly focused on guessing the direction of the market, as opposed to analyzing the fundamentals of stocks, then emotion appears to play the major role! Emotions of greed and fear are common among all humans. In less volatile markets, a seller may be paying college tuition or they may indeed know there is something wrong with a company. In a crisis, they may sell for the exact same reasons - or simply out of fear. Investors must constantly remind themselves that there is always a person on the other side of the trade. They must remember that bear markets will be the best chance to capitalize on others' fear. In this atmosphere of fear, it is a good time to be greedy.

"Bear markets have always been temporary. And so have bull markets. Share prices usually turn upward from one to 12 months before the bottom of the business cycle and visa versa."

– John Templeton

– Remember the second “cardinal rule of investing” - the stock market (like life) moves in cycles. Bull markets give way to bear markets which give way to bull markets again. Though we know that stock market cycles happen, unfortunately they are rarely uniform in their arrival, departure or length. This is what catches investors off guard, why they spend bear markets in a state of panic and why they frequently learn very little about how to act during bear markets. Nevertheless, in the long run there are traditionally fewer rainy days than sunny days. Guard against thinking that something will last forever, good or bad. Can you believe it was only months ago that oil prices were near $150/bbl and the talk was of $200/bbl prices? As of this writing, oil prices are around $64/bbl.

– Stick to your game. During market crises I inevitably hear “someone is making money.” That is probably true, though rarely does a great investor abandon his/her investment process for what is historically a limited period of time. When in trouble, good athletes fall back on that technique they can depend on. Amateurs often attempt something different, usually heroic, and in the process compound their problem. In a market crisis, some investors panic, insist on doing something different, and in the process end up selling at the low.

“I don’t want a lot of good stocks. I want a few great ones.”

– Philip Fisher

– Remember the old Wall Street saying, “It’s a market of stocks, not a stock market.” The past bull market had been characterized by “a rising tide lifts all boats.” In some ways, cheap money, easy credit, gorging on debt, a lack of regulatory oversight and just plain greed, contributed to that phenomenon. When the cycle of the next bull market starts, it will not be characterized by all stocks in the S&P 500 index (or any index) rising uniformly. I believe it will be a “stock-pickers” market not a “consultants” or “financial planners” market. I believe now is the time to be analyzing company fundamentals and investing, one by one, in the stocks of those companies which have a large market opportunity, superior products and execution, barriers to entry and strong management. Alternatively, you can selectively invest in portfolios of securities which operate in this same manner.

“Buy when everyone else is selling and hold until everyone else is buying. This is more than a catchy slogan. It is the very essence of successful investment.”

– J. Paul Getty

In summary, financial crises have periodically come and gone throughout the history of the United States (and the world), a fact that is never any comfort when you are in the midst of one! This crisis has been painful for a lot of investors who were highly leveraged and have been forced to liquidate to reduce that leverage. It has been painful and unfair to patient, and/or long-term, and/or retired, and/or conservative investors who were not “greedy” yet who have had to suffer anyway. I understand that.

As humans we overreact to both good and bad news. Clearly there is no business rationale for the 10% daily swings currently happening to the stock market. The underlying “value” of companies is not changing that much on a daily basis. Great investors like Graham, Templeton, Fisher, Buffett and Price knew that. They excelled by a combination of skill and, most importantly in my opinion, the distractions of fear in times of crisis or exuberance in times of boom on the part of other investors.

In the end, no one remains pessimistic forever. I have observed that bear markets are shorter than bull markets and bear markets go down less than bull markets go up. Take a page from the great investors. Keep emotions in check and, if at all possible, capitalize on other investors fear and lack of control during this trying time. The sun will come out again.

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Hear the Other Side

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