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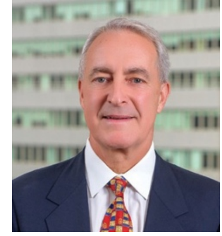
Thoughts for Investors



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Summer Newsletter

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"It will be a great city once it's finished."

– Anonymous

This line was once uttered about New York City. If one travels there today it is still apropos. The city is in a state of perpetual motion. Some buildings are being torn down while others are being built and still others are being restored. I was reminded of this on a recent visit. I seemed to be constantly stepping on, over or around the trappings of some project. On the way home though I had a much different perspective. The Metro liner exited the tunnel in New Jersey and headed south toward Philadelphia. As I looked back at the skyline, the city looked very serene, almost motionless. Nothing gave any indication as to what was happening, what the city was becoming. It was at that moment that I realized stock portfolios were like that as well. The last line of an account statement is a snapshot, taken at a single moment in time. Like that view of New York City, it's a glance back, and gives no indication about what is about to happen – good or bad.

In this newsletter I would like to make the case for coming to street level to see what's actually going on with the companies in one's portfolio. Look at your portfolio as a city being built. It's not necessary to do any actual construction, demolition or renovation yourself. Coming closer will, I believe, help investors understand and hopefully appreciate why all this recent volatility can lead to a stock portfolio that is as growing and vibrant as New York City.

Most cities began with a few buildings being built at the same time and with different functions. A portfolio starts this way as well and the core holdings change only gradually over a very long time. Only permanent disasters such as the building burning down cause rapid change. As a city grows new buildings are added. A point is reached in the life of a city when new buildings with very specialized functions such as indoor pools are added. So to with portfolios which round out their core holdings with specialized stocks that complement the portfolio and provide diversification. Eventually, in any vibrant and growing city, there are buildings in various stages of their ascent or decline. This is because some buildings may be old but are still useful while new building are built for functions that weren't in existence before (such as buildings to house computer equipment). Often, investors mistakenly assume that a successful portfolio is one in which all stocks are the same "age" and are–contributing equally. If some stocks are not contributing at all they assume that there is something wrong. In some cases, stocks not performing can actually be a sign of diversification or transition just like a building that is converted from a bank to a hotel. Over the last several years, many mutual fund investors have worked at "weeding" their portfolios, getting rid of the funds that weren't performing and loading up on the top performing funds per the instructions of Money magazine and others. Unfortunately, what they didn't realize, and couldn't tell by looking at the last line of their statements, was that many of their funds became invested in all the same stocks. Rather than having a diversified portfolio they had a city comprised of nothing but restaurants! Quite often a portfolio is healthier if a few stocks or funds are currently carrying the rest. For the best example of how diversification works one needs to look no further than to the "sage of Omaha", Warren Buffett.

WARNING before reading any further, reader BEWARE: The following contains material that might upset those who believe that Warren Buffett is infallible:

June 10, 2001 marked the third anniversary of the (currently) peak valuation of Warren Buffet's Berkshire Hathaway shares. On June 10, 1998 the price of Berkshire Hathaway class A shares was $80,000. By 3/10/00 the share price had declined to $40,000, for a 50% loss! And you thought only the NASDAQ could go down! The always vigilant financial press were sharpening their axes and stopped just short of calling Buffett senile. My favorite was a press commentary that he should just start asking his friend Bill Gates for advice about investing in new economy stocks. At the very moment that Berkshire Hathaway was reaching new lows, the NASDAQ was reaching new highs. You guessed it. Everyone was fleeing Buffets value investing and went running headlong into growth investing. A truly diversified portfolio containing both growth and value stocks would have insulated investors better than a portfolio containing only one style, like a city where different neighborhoods rise and fall. Looking at a city from far away only confirms that it exists. It doesn't show the changing landscape or the gradual advancement. Likewise with a stock portfolio. You can't look at it for one moment from far away for the proper perspective. To judge its growth you need to look at every holding, recognizing that one area advances while another may temporarily retreat.

"Do not follow where the path may lead. Go instead where there is no path and leave a trail"

– Ralph Waldo Emerson

Google's self-driving technology project, Waymo, issued a safety report stating their "fully self-driving technology has driven over 10 million miles on real world roads since 2009". Yet autonomously driven cars are not ready for general use. On the other hand, after a few Sunday mornings in the mall parking lot, parents will hand the car keys to their 16 year-olds. What does that say about the capacity of the human brain? What it tells me is that we are still a long way off from removing human discretion, judgment and experience from both driving and investing. Someday we may get to a point where driving and investing skills will be unnecessary. As of today, you still cannot ask, "Alexa, what stock will make me rich?"

"I've made most of my money in bear markets, I just didn't know it at the time"

– Shelby Davis, Davis Funds

I've repeated Shelby Davis's quote from the last newsletter because of its continued significance during this bear market. Mr. Davis discovered out that the greatest opportunities to make money come when things look darkest such as during times like this. Rather than seeing opportunity most investors panic and are later lament how they were the ones that sold at the low point. If you had bought more or held Berkshire Hathaway shares instead of selling them in March 2000, you would have been rewarded with an approximate 70% gain in a little over one year. There is one last part to the Berkshire Hathaway story. If you are marking your third anniversary with your Berkshire Hathaway shares, having purchased them at their high of $180,000 in June 1998 you are still underwater. As of this writing the current share price is $70,000.

Well What Do I Do Now!

Well as you can see the best portfolios contain both growth and value because they both provide opportunity. Furthermore, for best results it is preferable to invest in stocks whose style is currently out of favor and the more out of favor the better. For those who can't bear to have one style or the other there is still hope. You just need to wait longer until your preferred style comes back to the fore. Either way patience with your game plan is the key and try to have a full team on the field.

In summary, a portfolio, like a city, will always be a work in progress. There will be good and bad things going on simultaneously. Yet like the sign says we are always endeavoring to be "Making Your City Better."

"Buy when everyone 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 – from his book "How to be Rich"

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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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