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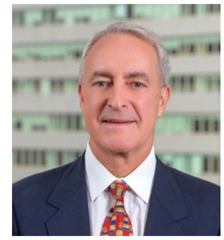
Thoughts for Investors



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"To win confidence in advance of success is the most difficult accomplishment."

– Napoleon Bonaparte

Webster defines discipline as "a particular system of regulations for conduct, a state of order maintained by training and control." Investing during these times requires a System for conduct maintained by training and control. Investing during these times requires discipline.

A SYSTEM

Webster defines a system as "… an ordered and comprehensive assemblage of facts, principles, or doctrines. Further, it defines a fact as "a truth known by actual observation." To develop an investment system one must participate in a full market cycle -- both the up and down periods. Yet, until recently, it had been a long time since there was an extended down period in the market. In fact, for many investors, and even some of their advisors, these times have been their first experience with a protracted bear market. Either they were too young or didn't have enough money at stake to be sufficiently worried during the last down market. Many investors either don't have a system or if they do, they don't follow it during rough times in the market. Their investing is done based on emotions. Buy what's going up to feel good and sell what's going down to feel relief.

Sometimes, there is added confusion when one investor tries to compare his system with someone else's system since every investor's system is usually unique. However, there are principles common to all investment systems such as "buy low and sell high" or "buy either earnings or assets" or "buy when others are despondently selling." Assembling principles such as these into a system of conduct is the first part of the discipline of investing.

TRAINING AND CONTROL

The second part of the discipline of investing comes from exercising the "state of order maintained by training and control." Training and control is the result of practicing and refining actions often enough that they become dependable under difficult circumstances. An example might be Tiger Woods' golf game. All professional golfers have great skills and are capable of playing rounds well under par. However, Tiger's control under pressure is unparalleled. Whether playing in the rain, or in the dark, or coming from ten strokes behind on Sunday afternoon, Tiger's success comes, in part, from training and control of his game. His swing is always the same. He doesn't change it because Alan Greenspan may raise interest rates in August! He trusts his abilities and therefore his actions are consistent with what he has learned. In fact, he depends upon his opponents to temporarily act irrational-- to abandon their system when they are under pressure. His biggest advantage is in his head. During the press conference after his win at this year's US Open, Tiger was asked if he could recall any mental mistakes he made during the tournament. Without hesitating, his answer was "NO." The questioner then asked him if, even going back as far as the Masters, he could remember making any mental mistakes. He just shook his head.

Investors need that kind of training and control during these difficult times. Too often the cry "but this time it's different" becomes the excuse to stray from their system. Three years ago it was different and we needed to abandon our system of investing, because we were in a "new economy." Twenty years ago it was different and we abandoned our system because high inflation was here to stay. Today we hear that the best days for the stock market are behind it. We here that stock prices will N-E-V-E-R be that high again, because with all the accounting scandals and threats of terrorism-- this time it's different, throw out everything we've learned about investing. I believe that many investors mistake emotional investing for a system maintained by training and control.

DISCIPLINE: AN EXAMPLE

Recently, a representative from a major mutual fund in Boston came to visit. We began discussing an article on international investing that appeared in that day's Wall Street Journal. After two years of negative returns for the S&P 500, the article was suggesting that people invest in international funds for diversification, and also because the dollar's decline would benefit those funds.

Some investors had long ago abandoned international funds, which were under performing, in favor of index funds, which were performing. Why invest in emerging countries with all their problems when you can invest in a great multinational giant like General Electric! Yet the investors whose system included worldwide diversification, and whose training and control caused them to stay invested in international funds over the last three years, were rewarded. One major foreign fund's three-year compounded annual returns thru 5/31/02 is more than 5% versus a negative 6.4 % for the S&P 500. John Templeton once said, "People are always asking me where the outlook is good, but that's the wrong question. The right question is: Where is the outlook most miserable?"

In summary the definition of investor discipline is assembling sound, tested investment principles into a system; and through training and control rather than emotions, using that system to maintain a state of order during volatile market times.

P.S. The representative from Boston pointed out that his emerging markets income fund -- invested in Brazil, Russia, Venezuela, Columbia and Nigeria -- had a three-year compounded annual return of more than 16% thru 5/31/02. How many investors I wonder had the training and control to invest there three years ago?

"'This time is different' are the most costly four words in market history"

– John Templeton

AUDI PARTEM ALTERAM

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.

Thoughts for Investors is a quarterly newsletter written for clients since 1997 by this author. The purpose is two-fold. First, it is meant to help explain the investment philosophy that guides the author's approach to portfolio management. Second, it is meant to remind readers of important behavioral skills that the author believes are necessary to help them become successful investors. The author welcomes comments and criticisms, especially if they can be shared for the betterment of all investors. Quotation is permitted with full attribution.

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