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Thoughts for Investors

Summer Newsletter

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One of the pleasures of a warm summer evening in Philadelphia is going to Veterans Stadium for a Phillies game. The cool night breeze, the glare of the stadium lights, the darkness of the sky overhead, the fellowship of friends sitting next to you – and of course, the game. They all make for a respite from a hot, busy day.

It was during one such evening, and during a lull in the action (which is inevitable at a Phillies game), that I realized how similar investing is to baseball. In this newsletter I would like to outline six points of similarity while noting a few differences and suggest that while most of us will never get into the Baseball Hall of Fame, we all have a chance to get into the investor Hall of Fame.

POINT #1 – A .300 BATTING AVERAGE SHOULD GAIN A PLAYER ENTRANCE INTO THE BASEBALL HALL OF FAME

Recently deceased Baseball Hall of Famer, Ted Williams batted an astounding .406 in the 1941 season, and no player has hit .400 since. Normally, if a baseball player can achieve a .300 batting average over a lifetime, he has a very good chance at the Hall of Fame. A .300 average means only 3 hits out of 10 “at bats”. However, investors quite often give up if they are not hitting at least 7 out of 10 “at bats”.

POINT #2- IN ORDER TO STAY FOCUSED ENOUGH TO GET THE 3 HITS OUT OF 10 AT BATS, A PLAYER MUST MENTALLY PREPARE FOR THE 7 AT BATS OUT OF 10 THAT PRODUCE OUTS.

The key words are mentally prepared. As if the prospect of “striking out” 7 out of 10 times is not enough, a player must be mentally prepared for the circumstances in which they occur: bases loaded; bases loaded bottom of the ninth, with two outs; or bases loaded, bottom of the ninth, two outs in the last game of the World Series. How a baseball player handles each of these situations will help determine which player is a Hall of Fame candidate.

Hall of Fame investors face the same issues. Do you quit investing in stocks after the first stock you invest in doesn't go up? After it goes down? After the seventh straight stock goes down? After the seventh straight stock goes down in a bear market? Hall of Famers (of both baseball and investor variety) ignore all the boos because they know that as long as they stay consistent with their approach, practice and learn from their mistakes, they will improve their average. Both investor and baseball Hall of Famers know that sometimes events beyond their control (such as a recession or fan interference) affect their performance despite their preparedness, and they don't give up. They are patient.

Investors also have one big advantage over baseball players with regard to an “at bat.” In baseball, when the umpire calls a third strike the “at bat” is over. In contrast, an investor may initially “strike out” with a stock and later have it come back. Hall of Fame “value” investors keep batting while other investors think the “at bat” is over. As Yogi Berra said, “It ‘ain't over ‘til it's over.”

POINT #3- IN BASEBALL, A HOME RUN, A SINGLE, AND A STRIKEOUT RECEIVE EQUAL WEIGHTING

WHEN CALCULATING BATTING AVERAGE. IN INVESTING EACH "AT BAT" CARRIES A DIFFERENT WEIGHT.

Baseball players with lots of home runs versus strikeouts get in the Hall of Fame, as do players whose careers consist of mostly singles and doubles instead. This is because in baseball, every at bat carries the same weight and this may be a point where baseball and investing digress a bit. A baseball player who goes 0 for 2 in his first 2 at bats and then gets 2 hits still finishes the day 2 for 4 for a .500 average. The first 2 at bats didn't ruin his chances for having a good day.

It's more difficult for investors though. If your first 2 investment at bats result in outs then you have less principal to invest for the last 2. As a friend said, "it's as if they cut inches off your bat whenever you make an out." And this is where diversification plays a role. Diversification would prevent you from "swinging for the fences" with all your principal on the first at bat, thereby saving some principal for the next at bat. As I've written previously, painful as it is, the most an investor can ever lose in one at bat is 100% of that investment. So if the diversification plan was to divide the investment capital into ten equal investments, then a home run through an early investment in Microsoft, Qualcomm, or Wal-Mart would make up for many strikeouts. (I have assumed that equal size investments have been made and the definition of a "home run" is rising over 100%.)

POINT #4- THERE IS NO ONE IN THE BASEBALL HALL OF FAME WHO IN THEIR FIRST 10 AT BATS IN THE MAJOR LEAGUES WENT 10 FOR 10 (OR 3 FOR 10) AND WAS IMMEDIATELY INDUCTED.... ALTHOUGH THERE MAY BE SOME WHO STARTED 0 FOR 10.

Baseball Hall of Famers have been inducted based on accomplishments that span their entire careers. Some years were great, and some mediocre, yet they kept coming to bat or taking the field. They always feared regressing to the average of all players so they were constantly working on their skills. Likewise, Hall of Fame investors aren't one-shot-wonders either. The late bull market created many investors (and investment professionals too) who had one or two good

years and felt they deserved immediate induction. With the bear market upon us they have now either stopped practicing or worse yet have stopped playing. These are sure ways to regress to the average of most investors and reduce their chances of getting into the investor's Hall of Fame.

POINT #5- MOST BASEBALL HALL OF FAMERS DON'T GET THERE SIMPLY ON THE STRENGTH OF THEIR BATTING.

Some Hall of Famers are good fielders or base stealers. In the case of pitchers, their batting averages are usually mediocre, but their pitching win/loss records are great. This is true to some extent with investor Hall of Famers. While making a good return is the cornerstone of all Hall of Fame investor, everyone gets there using their own style. Some do it through growth investing, others through value investing. Some invest exclusively in small cap stocks, others in large cap, still others in all-cap or bonds.

POINT #6- MOST BASEBALL HALL OF FAMERS HAD PREDECESSORS WHOSE STYLES THEY EMULATED.

Many Baseball Hall of Famers have adapted their personal styles of play from their idols, managers, or teammates. In addition, they have looked to these same people for the development of their "inner game," an overall mental strategy that they can apply to every at bat. Hall of Fame investors must also have a great "inner game." They depend on the help of great investors such as Fisher, Templeton, Buffett, Price, Cabot etc. for their philosophies and strategies.

In summary, these are trying times for potential Hall of Fame investors. There are plenty of "experts" up in the upper level seats shouting down instructions. There are also many "experts" who, with the added clarity of the replay flashed on the Jumbotron, can point to every mistake after the fact. Remember though, of all the people in the ballpark the only ones with the chance to get into the Hall of Fame are those players or investors who are in the game.

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Hear the Other Side

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