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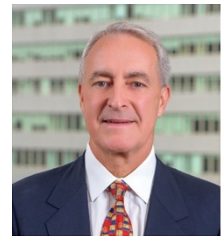

Thoughts for Investors

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Summer Newsletter to Clients

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Summer is a time for vacations, barbecues, and summer reading. My reading preferences fall almost exclusively in two groups. The first is biographies. I've read some wonderful books on Lincoln, Churchill, Rockefeller, Grant, Chaing Kai-Shek, and Joe Johnston to name a few. If you were interested, I'd be happy to provide more details on my favorites. The second group is investment classics, but not the ones authored by reporters or magazine writers.

One of the greatest introductory books on investing ever written is The Money Masters by John Train. Over the years I've handed out dozens of copies. For those interested in reading it, I would suggest the original.

According to the cover, The Money Masters is a compilation of the winning strategies of nine great investors and "how you can apply" those strategies. Sometimes though, "applying" them is about as easy as a novice golfer reading a golf instruction book and then expecting to go out and shoot a round in the 70's. It's a lifelong process. Even though John Templeton started investing as a young boy, he didn't adopt the philosophy that ultimately made him successful until age 56. In fact most people who consider themselves investors really aren't. Benjamin Graham, in a women's magazine many decades ago, defined an investor.

He said that an investor is someone who "buys their stocks as they bought their groceries, not as they bought their perfume." In other words, an investor is someone who has an investment philosophy and a strategy for executing that philosophy. And the most important ingredient in formulating a philosophy and a strategy seems to be investor temperament. According to dictionary.com, temperament is simply "the manner of thinking, behaving, or reacting characteristic of a specific person." Investor temperament is how an investor thinks, behaves, or reacts to the markets. More specifically, it's their emotions. In this newsletter, I would like to share the concepts of proper investor temperament as described by the nine great investors in The Money Masters.

Temperament According to Warren Buffett

· Buy what is out of fashion…prepare to be patient.
· Avoid fad stocks and fad industries. If they start a mutual fund to specialize in it, it is a fad.
· The independent investor has an enormous advantage in that he can stand at the plate and wait forever for the perfect pitch. Many times though he (and even fund managers) swing at far too many pitches. They seem to hear the crowd in the stands howling "swing you bum."
· Own only a dozen or so securities against the traditional "Noah's Ark" approach of diversification. Buy two of everything in sight and you end up with a zoo not a portfolio.
· Make a decision and leave it at that, without feeling the need to consult other people – no committee. If you don't know enough to make your own decisions, you should get out of decision making.
· If you lack confidence, fear will drive you out at the bottom. It's as though you bought a house for $500,000 and immediately told the broker that you would sell it if you got a bid of $400,000.
· Lack of marketability (liquidity) is unimportant to a true investor.

· Be flexible in the type of businesses you buy.
· Forget technical analysis. It is not knowable from what a stock did last month or last year how it will do next month or next year. It's like an astronomer setting aside his telescope and picking up the astrology page.
· Don't worry about not being right on every investment. You won't be. Just try to be right on a couple of things a year. As Ted Williams said, "to be a good hitter, you have to look for a good pitch."

Temperament according to Paul Cabot

· Care and realism is his approach.

Temperament according to Phillip Fisher

· "I don't want a lot of good investments, I want a few outstanding ones."
· You can make a lot of money by investing in an outstanding enterprise and holding it for years and years as it becomes bigger.
· "It's a good deal easier to know what's going to happen than when it's going to happen."
· Buy when earnings are depressed and investors are discouraged. Buy on bad corporate news or other temporary misfortune. Buy when there is a war scare.
· Instead most investors buy when they've sifted through masses of economic data and conclude that the business outlook is favorable, sometimes even consulting investment newsletters or magazines which tell them to hold off "until the outlook clarifies." Bull markets end and bear markets begin in good times when everyone's optimistic. The bottom comes in bad times when everyone's desperate.
· You should not sell because you think the market is due for a slide or because a stock has "gotten ahead of itself." Selling for either reason implies that you are clever enough to buy the stock back more cheaply later. If you think the stock has a reasonable prospect to triple, why sell it if it is 35% overpriced today?

Temperament according to Benjamin Graham

· Sometimes the patience needed may appear quite considerable. In his book The Intelligent Investor he gives an example of having to wait 3 ½ years for one stock to go up. "A favorable purchase is likely to seem odd, uncomfortable, risky, dull, or obscure at the time you buy it."
· The passion of the crowd creates over or under valuation. "While enthusiasm may be necessary for great accomplishments elsewhere, it almost invariably leads to disaster on Wall Street."
· Any simple mechanical technique, without the "leap of faith" required in all investing, is bound to wear out, lose followers, and eventually come back again (like the tides). When the formula wears out move on. Predictive formulas lose their utility just when a playback shows them to have worked well retrospectively. At the end of his life he reversed some of his ideas because everyone was using those techniques.
· "The market is there to serve you, not to guide you". In other words take advantage of opportunities. Don't wait for the market to tell you what to do. Temperament according to Stanley Kroll, commodity trader
· Never pyramid. A typical investor mistake is to increase the size of his order as the trend continues.
Most investors put little, if any, money in the market during a bear market (in fact most take money out).
However they put more and more money in during a bull market. At what turns out to be the top of the market, they can't seem to put money in fast enough. The correct approach is to put less and less in as the market price rises.
· Exclude any information that is not completely certain to be true.
· The easiest way to purge oneself of the herd instinct is to simply not know what the crowd is doing so he refuses to listen to "news".
· One of his favorite quotes from a book by Edwin LeFevre – "It was never my thinking that made the big money for me. It was always my sitting. My sitting tight. You always find a lot of early bulls in a bull market and early bears in a bear market. Men who can be both right and sit tight are uncommon. I found it one of the hardest things to learn."
· Another favorite quote, by Jesse Livermore, "Money is made by sitting, not trading."

Temperament according to T. Rowe Price

· Seek "fertile fields of growth" then hold on for long periods of time.
· He did not believe in specific predictions of a company's future. "Do not try for a pinpointed mathematical approach that creates an illusory certainty out of an unknowable future."
· The highest investing virtues are

1. Common sense,
2. Realism,
3. Flexibility.

Temperament according to John Templeton

· "A flexible viewpoint is the professional investors greatest need." Everything has its season, which does not last forever.
· The best bargains will be in stocks that are completely neglected. And you must get ready to change when everything seems to be working particularly well.
· Don't trust rules and formulas. (see Benjamin Graham, above).

Temperament according to Larry Tisch

·"I have no system, I'm a pragmatist. Most people don't have the discipline to stick to a system." He took advantage of that lack of discipline.
· On whether growth or value is better: No! Anything has its price.
· Most investors don't beat the market because they are the market

Temperament according to Robert Wilson

· Any successful approach to investing is bound to fail in due course so be flexible and ready to adjust
· Unless there is fear in a stock, it probably doesn't have a great capital gains potential.

Summary

Temperament is the single greatest characteristic of an investor. Proper temperament requires patience, flexibility, and realism. The market provides the opportunities (in the form of a stock quote that is under or over valuing a stock) and the investor either takes advantage of it or not. He doesn't wait for the market to guide him.

An investor is also oblivious to what the crowd is thinking. He does not depend on newspapers, magazines or newsletters as they are written to maximize copies sold. Some would be investors also mistakenly put their trust in magic formulas, or "black box" approaches such as indexing. The appeal of putting the investment process on "auto-pilot" is very tempting yet ultimately doomed. In the end, everyone adopts the same approach and the technique loses its effectiveness. They seem to believe that these techniques will somehow absolve them of the need to practice proper temperament.

Take a look at your investor temperament. Reflect on how outside influences affect your own ability to become an investor. A tip that might help improve your temperament is to pay attention to the history of the markets. Veterans in any field of endeavor usually exhibit better temperament than rookies because they've "seen it before." This is also why, anecdotally, many seasoned investors seem to have fared better in this down market cycle than those who only began seriously investing in stocks in the mid to late nineties. The seasoned investors seem to have stayed the course better than those who panicked and sold out at the bottom.

So go back to your barbecues, read that book on golf, enjoy your vacation, and make a little time to understand your investor temperament.

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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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