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# Thoughts for Investors

## Summer Newsletter to Clients

AUGUST 2005

***“The stock market climbs a wall of worry.”***

– Old Wall Street proverb

For over 22 years I have been studying the investment techniques of great investors such as Templeton, Fisher, Graham, Buffett, Miller, Dreman, and others. In my quarterly newsletters I try to share some of what I have learned from these “Money Masters”. One theme common to all these investment greats is the need to control emotions when investing.

There is seemingly no limit to the amount of backward-looking analysis or forward-looking forecasting that bombards investors every day. With so much information to digest, it is no wonder that investors can give up and act on their emotions. How can one assess the impact of a “9/11” on Microsoft? In the end, we all believe that we act rationally. It is everyone else who acts irrationally.

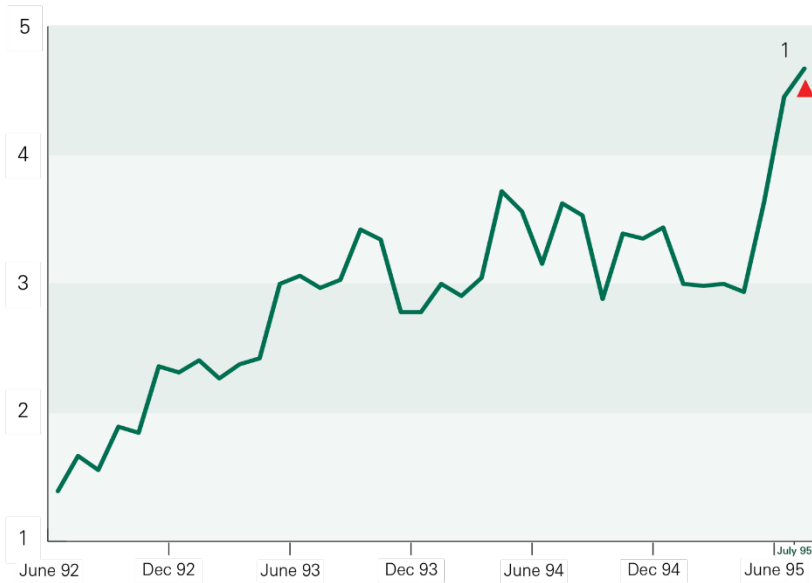
***“Your own mind is a sacred enclosure into which nothing harmful can enter except by your permission.”***

– Ralph Waldo Emerson

In this newsletter I will try to illustrate how emotions, despite our best intentions, can cloud judgment. Below are several charts of the monthly stock price movement of Starbucks Corp., a well-known coffee company, from its beginning as a public company until July 2005. Each price point represents the actual closing price that month. Next to each chart is commentary that, while fictitious, is symbolic of the range of investor emotion to Starbucks’ stock price movement. At the bottom of each comment section I ask the reader to answer the

same question –should they buy/sell/do nothing? I have purposely left out any fundamental research available at the time. I have chosen to leave it out because even if the available research had been 100% true and accurate, investors, when forced into a buy/sell/do nothing decision, will often go with their emotion instead.

Please consider taking this emotions test. To get the full effect, do not skip to the end, you will ruin the surprise.



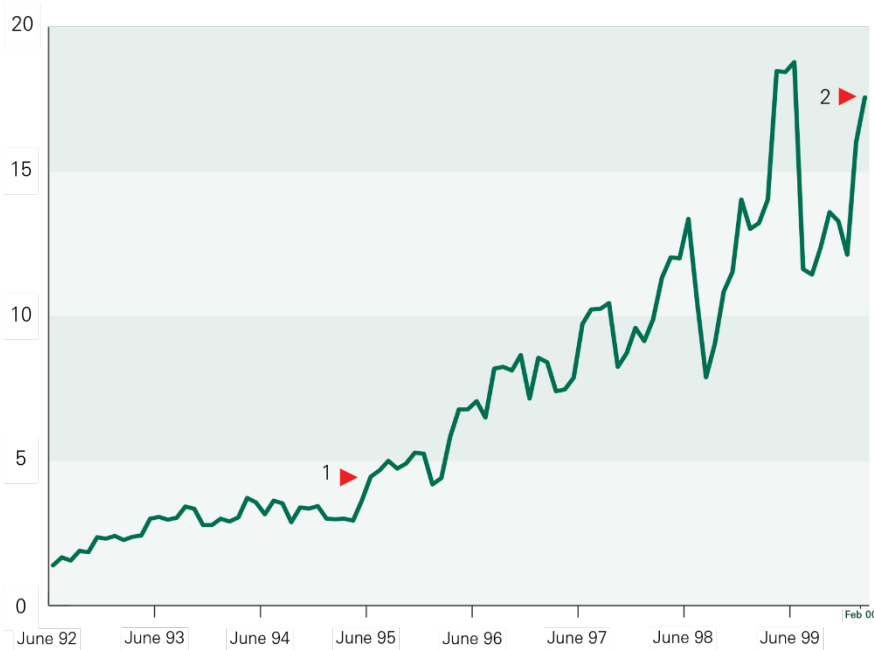
### 1. July 1995 — \$4.67

Boy, I wish I had known about Starbucks three years ago when it went public. Look at this line – all for a cup of coffee. The stock is up over 250% now. I guess I missed it.

#### Question:

Should I buy/sell/do nothing?

Data Source: Reuters



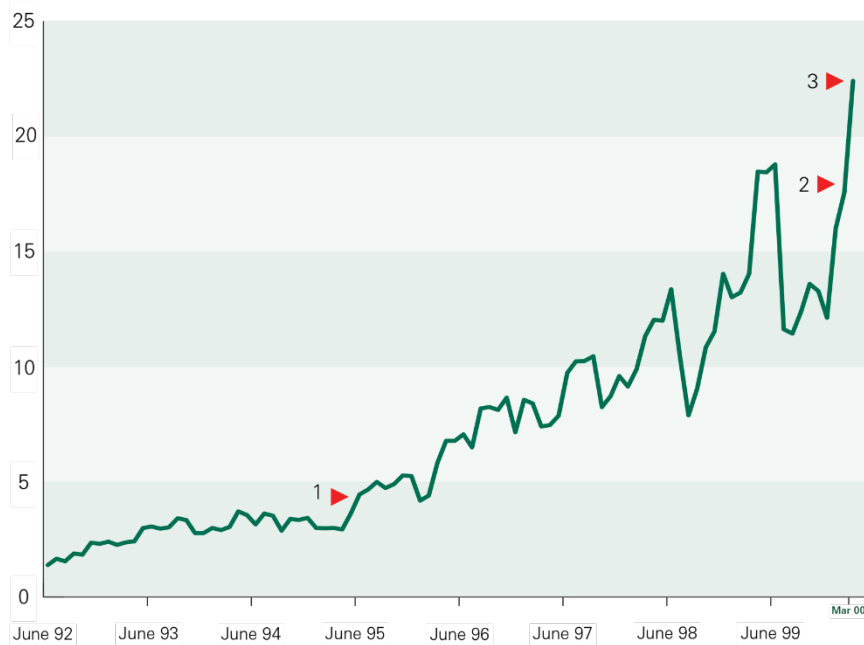
### 2. February 2000 — \$20.00

Starbucks is up almost 275% from when I didn't buy it a few years ago. Seems like there's a coffee shop on every corner! I wish there was one in my building.

#### Question:

Should I buy/sell/do nothing?

Data Source: Reuters



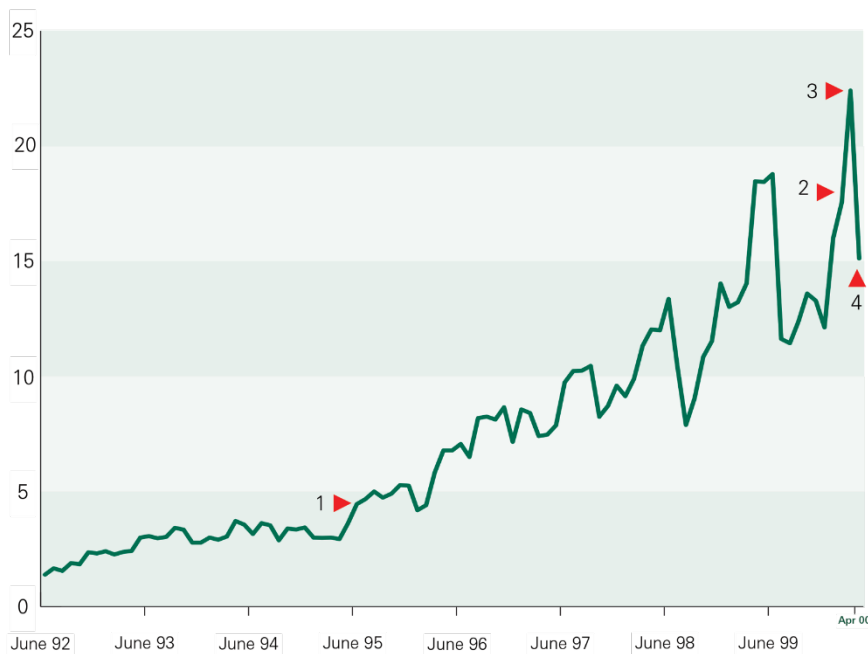
Data Source: Reuters

**3. March 2000 — \$22.40**

Can you believe it? Starbucks is up over 27% in one month. I should buy some. The whole stock market is doing well, everyone is so optimistic about the future. I don't want to miss it. Besides, there are Starbucks counters in the grocery stores now! I'm buying the stock!

**Question:**

Should I buy/sell/do nothing?



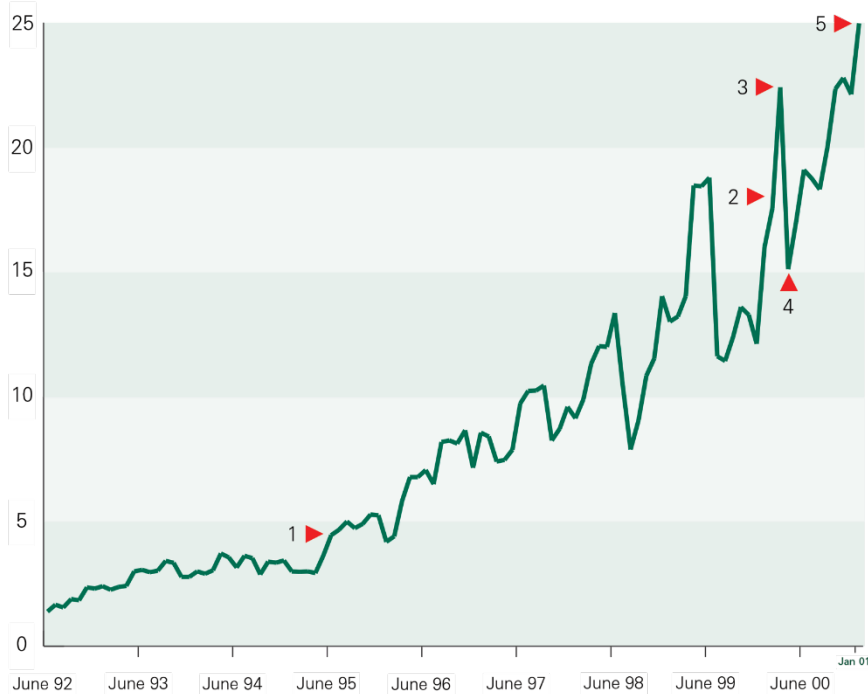
Data Source: Reuters

**4. April 2000 — \$15.11**

What was I thinking? This stock is now \$15. I've lost almost 33% in one month. I'm going to cut my losses and sell. Besides, how many new coffee inventions can they make? Plus, the stock market looks terrible!

**Question:**

Should I buy/sell/do nothing?

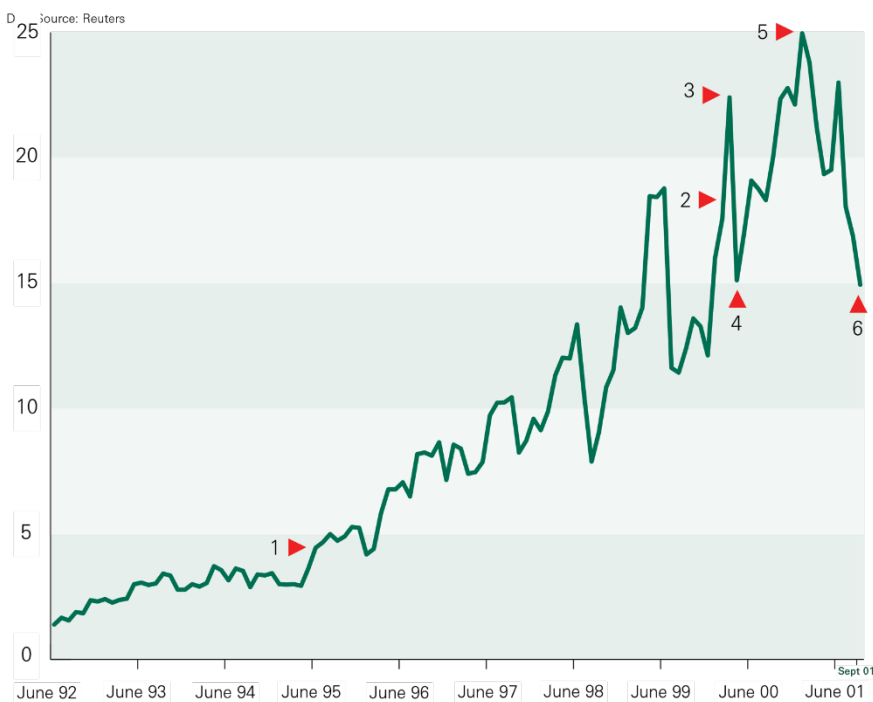


### 5. January 2001 – \$24.96

How can this happen? The stock is up 66% in less than a year – and during a bear market. I guess I shouldn't have sold after all. I'm certainly not buying now!

#### Question:

Should I buy/sell/do nothing?

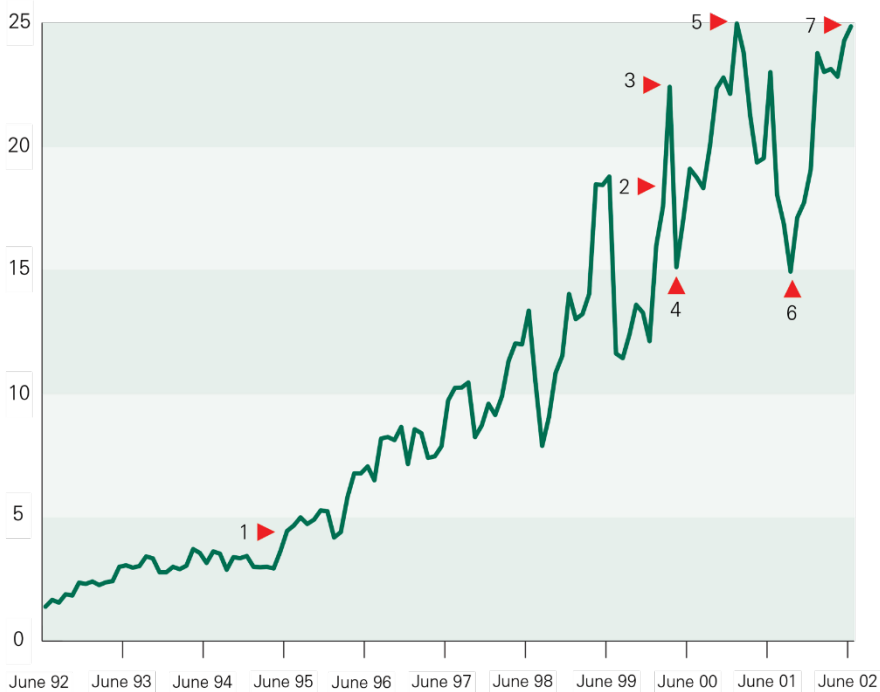


### 6. September 2001 – \$14.94

Boy, I finally got it right. Good thing I didn't buy. The stock is down almost 40% and the P/E at 30 is still too high. What's going to happen to the economy, and to the country, after these terrorist attacks? By the way, aren't \$4.00 lattes passé?

#### Question:

Should I buy/sell/do nothing?

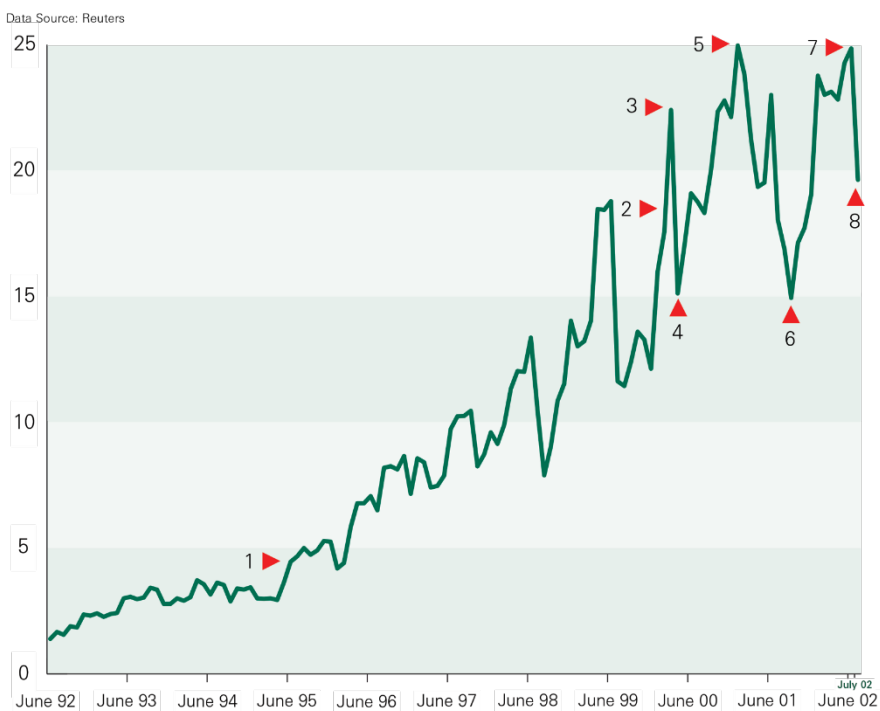


### 7. June 2002 — \$24.85

Darn it! I should have bought. It's back up to its old high. That's almost a double from a year ago. I had a feeling the U.S. would come back after 9/11! Should have gone with my hunch. Oh well, I'll wait and see if it goes down a bit, then I might buy some. After all, \$25 is the all time high and the P/E is even higher now. It's 45. Everyone said don't buy high P/E stocks. I've learned my lesson with high P/E stocks – no more of those. Everyone is worried about the economy and the stock market looks terrible. Everything else is at a low.

#### Question:

Should I buy/sell/do nothing?

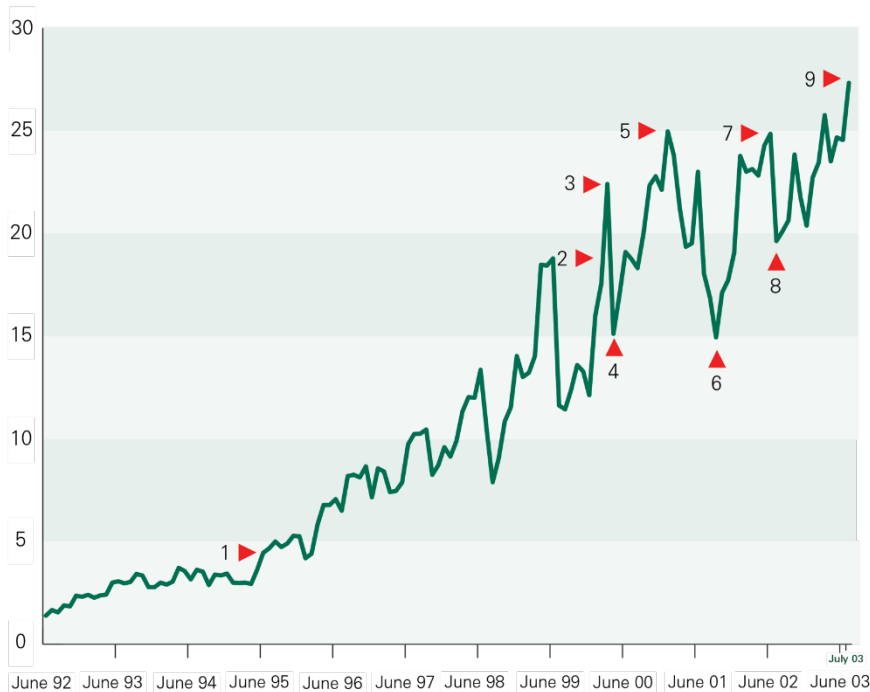


### 8. July 2002 — \$19.63

Good thing I waited. The stock is down over 20% in one month. Everyone is right. We are going into a recession. The consumer is done. I'm not sure if I want to buy this stock at all anymore. It's been ten years since it went public. Surely the glory days are behind it. I'm going for a latte. Anyone want one?

#### Question:

Should I buy/sell/do nothing?



### 9. July 2003 — \$27.33

It's been one year since I gave up watching this stock. I guess I shouldn't have been so negative. I should have bought when it was down. I shouldn't have listened to all that negative commentary. It's up almost 40% in one year!

But it's too late now. It's at an all time high, and the P/E is 40.

#### Question:

Should I buy/sell/do nothing?

Data Source: Reuters



### 10. July 2004 — \$46.99

I've got to stop watching this stock. It's up over 70% since this time last year! Can you believe it? The P/E is 49 now! Who would buy a stock with a 49 P/E? Not me!

#### Question:

Should I buy/sell/do nothing?



Data Source: Reuters

### 11. July 2005 — \$52.50

Starbucks is up 12% since last year. I was told stock selection didn't matter, that it was asset allocation that would assure me a good return. Yet the Dow, the NASDAQ, and the S&P 500 index are all flat or down. I guess there is some truth to the old Wall Street saying "The stock market climbs a wall of worry." Unfortunately I shouldn't even think about buying a stock with a P/E of 45.

## Epilogue

To this day, investors struggle with the question of whether to buy, sell, or do nothing with Starbucks stock. Is this a growth stock anymore? Can the company get any better? What about all the competition? And what about the economy? What impact might that have on Starbucks future? Is the stock expensive or cheap? Yet as all these thoughts swirl through investors' minds, buffeted by emotion, the management of Starbucks endeavors to move the company forward.

As demonstrated by the success of Starbucks' stock price, the buy and hold philosophy for investors is still valid. An investor smart enough to buy the stock in the early '90s needed only to "hang-on" and be patient — no small accomplishment. (See my earlier newsletter on the importance of patience.) It should also be obvious from this example that stocks can be volatile. The buy and hold investor surely had many points

along the way at which to panic. Who would not be unnerved by a 30% or 40% decline (sometimes in one month)? Shrewd investors use volatility (and emotion) to their advantage. I do recognize that it takes a Herculean effort to buy when it seems everyone else is selling! Nevertheless, emotion would have allowed an investor to get into Starbucks stock nine years after it went public and still make a great return. (September 30, 2001 at \$14.94 to July 29, 2005 at \$52.50 is a 252% total return, dramatically different than the 25.1% return of the S&P 500 index over that time period.)

The final chapter of the story of Starbucks Corp stock has yet to be written. For those investors able to harness the power of investor emotion, there are, and will always be, stocks like Starbucks out there.

***"I have had a lot of worries in my life, most of which never happened."***

— Mark Twain

## 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](mailto:al.boris@alexbrown.com).

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