



Albert C. Boris, III  
Managing Director, Investments

# Thoughts for Investors

## Summer Newsletter to Clients

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### HOW TO SURVIVE A BEAR MARKET- WHAT WE CAN LEARN FROM NATURE

Bear markets are very painful. I have lived through a few since entering this business in February 1984. What I have observed during bear markets is that they evoke action (based on reason) and reaction (based on emotion) that, in the long run, lead to the real mistakes that damage portfolios. Unfortunately (or fortunately) emotion and reason are human traits. Let me contrast human emotional reactions to the unemotional actions of nature (instinct versus reason) during periods of difficulty. I enjoy watching the Animal Planet network with my children. Recently, we watched a show about herd animals in Africa crossing a rain-swollen river after a storm. It struck me that there is a lot we humans can learn from nature about how to act during our periods of turbulence- such as bear markets.

1. Stick to your hunting technique. The stress of a bear market is not the best time to try new hunting methods that seem to be working for someone else. In difficult times, lions do not begin to hunt in the river, nor do crocodiles attempt to hunt on the open grasslands.

***“This time is different’ are among the most costly four words in market history”***

– John Templeton

2. Be careful when following the herd. In fact Bernard Baruch, adviser to presidents, admonished: “Never follow the crowd.” Often, early investors will spot an opportunity that results in a nice return. These investors can be compared with the first animals that successfully cross the river before the crocodiles are

aware of their presence. In reality, many more animals actually die from drowning than by being caught by the predators. This is because they are too weak, old, or inexperienced to cross a rapidly flowing, rain-swollen river. While most can swim, the current is stronger than normal after a rainstorm. Even strong and healthy animals get trampled by the herd or get swept away in the resulting confusion and disorientation. The crocodiles end up doing little work for this easy meal.

Likewise, many investors follow the herd into popular investments, only to see their portfolios drown in the rush to get out (or in) during the confusion of a bear market. Today, many investors want to get out of real estate or stocks with falling prices, and want to get into commodities. Many are “over their heads” and do not realize that they are following the herd; most are simply too late and become an “easy meal”.

***“To buy when others are despondently selling and to sell when others are avidly buying requires the greatest fortitude and pays the greatest ultimate rewards”***

– John Templeton

3. Put the current conditions into perspective. Animals in the wild seem to know that rain-swollen rivers do not stay that way forever, so they do not drastically change their behavior as a result. Bear markets historically have not lasted forever either – even if all the news and analyses seems to indicate otherwise.

Humans tend to project. In the past, some investors acted as if real estate would go up forever. Today, they are acting as if many stocks will be going to zero.

Certain investors are also acting as if commodities such as oil, metal, and corn will rise indefinitely. Respect the cyclicity of nature.

***“Now that the bear market for stocks has lasted three years, it is well to remember that both bear markets and business depressions are temporary. People do not remain pessimistic forever.”***

– John Templeton 1949

4. Lift up your head, look around, and pounce on opportunities. Be patient and in control of your emotions. When crossing a river, herd animals follow each other into the water, seemingly oblivious. Humans, on the other hand, are not limited to being reactive. We have the mental capacity to be proactive as well (which involves reason and the control of emotion). A bear market is a great time to be a predator since the prey is usually distracted and easier to catch. If you wait to hunt until all the conditions seem perfect, you might find that the prey has wandered off or been eaten by someone stronger or quicker.

***“Bull markets are born on pessimism, grow on skepticism, mature on optimism, and die on euphoria”***

– John Templeton

5. Be persistent and don't give up. Predators do not and can not give up after failing to catch something. Their lives and the lives of their offspring depend upon their persistence. While it may not mean life or death, many successful investors have failures, often over and over again. One can not be expected to “make a killing” on their first try or on every try. It takes multiple attempts to be a successful hunter or investor. The greatest mistake I see novice investors make is that if they do not make any money on the first few stocks they invest in, they give up. The second greatest mistake is that when they get caught in their first bear market they panic and give up. The greatest mistake I see experienced investors make is running out of energy for the “hunt” for great investments.

Also, be ready to see some successes “get away”. Warren Buffett has said that three times in his career he has lost half of his net worth. As of the writing of this newsletter, his Berkshire Class “B” shares are down nearly 30% from their high in December 2007. Even in a river teeming with prey, crocodiles miss, or have the prey escape their grasp, or even have it stolen by larger crocodiles. Most often, a predator's success comes from zeroing in on one animal and pursuing it relentlessly. Failure comes from half-hearted attempts at multiple animals, like an investor chasing after “hot” investments.

***“Don't become discouraged, and certainly don't try to recoup your losses by taking bigger risks”***

– John Templeton

In summary, there is a lot we can learn from nature about how to survive a bear market. Yet unlike animals, humans have the gifts of reason and emotion. This is both a curse and a blessing because reason and emotion lead us both in and out of bear markets. While investors can save money by acting appropriately during a bear market, often the best opportunity to make money is also during a bear market – if you learn how to harness these gifts.

On a sad note, John Marks Templeton, one of the all-time great value investors recently passed away at the age of 95. It is somewhat ironic that this happened during a bear market because Templeton became famous for his opportunistic investing during bear markets, his “search for bargains”, and his “avoidance of popular” investments. I had the great opportunity to meet and speak with him several times. His personality and his style of investing has impacted me and shaped my investment style. For this I am grateful.

***“When I think of the progress we have made during my lifetime in improving the quality of life and when I extrapolate that progress into the future, I cannot help being optimistic”***

– John Templeton 1912-2008

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*Hear the Other Side*

The Boris-Kaplan Group // 1735 Market Street, Suite 1400 // Philadelphia, PA 19103 // T 215.563.2300  
[www.alexbrown.com/boriskaplan](http://www.alexbrown.com/boriskaplan)

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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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