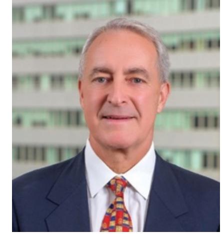
ALEX. BROWN
A DIVISION OF RAYMOND JAMES

THE BORIS-KAPLAN GROUP



Thoughts for Investors

Albert C. Boris, III
Managing Director, Investments

Fall Newsletter

OCTOBER 2011

"Mr. Market is here to serve you not to guide you"

Benjamin Graham has been called the "Father of Value Investing." With the recent wild swings in the stock market, I thought it important to introduce you to volatility's leading suspect and Graham's creation, "Mr. Market." That is the topic of this newsletter.

The fictional "Mr. Market" is an investor and your business partner. Unfortunately he suffers from mood swings that may occasionally involve and upset you. On days when the world outlook is bright, he becomes euphoric and wants to buy out your share of the business. On days when the world outlook is bleak, he is pessimistic and wants to sell you his share. His mood can literally change from minute to minute depending on his view about inflation, interest rates, unemployment, elections, GDP growth, terrorism, the US Dollar, the Euro, the weather, etc. The more pessimistic and depressed he becomes the lower the price at which he is willing to sell to you. It is critical to note two things when considering what action you should take in response to his offers. First, Mr. Market's mood usually outweighs any calculations of value he may have done. Second, per my "Cardinal Rule of Investing," all transactions require both a buyer and a seller; he cannot sell unless you are willing to buy nor can he buy unless you are willing to sell.

As an owner, you should know the value of your business and realize it does not fluctuate as wildly as Mr. Market's emotions. It is always your choice to accept or reject his offers to buy or sell. If he insists on selling, the best time to buy his share is when he is at the peak of pessimism. Keep in mind he is only there to "serve" you by offering his share to buy or sell. He is not there to "guide" you toward making the correct decision.

"It's not what you don't know that hurts you. It's what you do know that 'aint so"

– Mark Twain

Just as Mr. Market often forgets about value and makes decisions based on emotion, so do stock investors. It has been said that while emotions drive stock prices in the short run, value drives their price in the long run. In Graham's words, "In the short run the stock market is a voting machine but in the long run it is a weighing machine." Said another way, in the short run the stock market is a popularity contest, a poll. In a takeoff of a 1936 study by economist John Maynard Keynes, Yale professor Robert Shiller recently suggested that investors may be picking stocks based on which ones they think other investors will find the "prettiest" (think gold or Apple stock). Exchange Traded Funds (ETFs), now even allow us to buy baskets of the pretty ones like commodities or "short" baskets of the ugly ones like industrials. It is understandable how investor decision-making got this way.

"Never follow the crowd"

– Bernard Baruch

A seemingly endless flood of "important" economic data and opinion washes over us daily. It demands our attention and analysis. It goads us to act. It also makes us tired and cranky and so we often "follow the crowd" out of fatigue. In the long run substance matters most. Investors should forget about what is popular or "pretty"

and think about what companies possess the most "weight."

In his book "The Intelligent Investor," Benjamin Graham gives the following advice, "Confronted with a challenge to distill the secret of sound investment into three words, we venture the motto, Margin of Safety." "Weight" and "Margin of Safety" are the same concept. Many companies today possess them in the form of a huge cash cushion, no debt, patents, great products, great management, great research, proven market acceptance, or all of the above.

"The circulation of confidence is more important than the circulation of money"

– James Madison

In summary, every day there are new "voters" and new "votes" being tallied. Indeed with "computer driven trading", votes to "buy" or "sell" are now being tallied by the millisecond. Does this allow any time for "weighing" the long term merits of a company? When the stock market volatility gets depressing (of course only negative volatility is depressing), and it seems everyone is dumping stocks, remember two things. The first is that a seller can only sell if he finds a buyer to buy. While billions of shares may have been "dumped" by investors recently, those very same billions have also been bought by other investors. Ask yourself why is the buyer on the other side of the trade willing to take the risk? Hint: there is only one reason. The second thing to remember is that you are not alone. Confidence is low right now and so investors seek the comfort of the crowd. Yet crowds tend to act irrationally (on the upside as well as the downside). This is the time to harness the power of volatility, fatigue, and irrational thinking created by Mr. Market, his mood swings, and the voting/weighing machine. John Templeton warned that thinking "this time is different" may be "among the most costly four words in market history" to which I would add, if you let Mr. Market make your decisions for you.

"I think the future of equities will be roughly the same as their past; in particular, common-stock purchases will prove satisfactory when made at appropriate price levels. It may be objected that it is far too cursory and superficial a conclusion; that it fails to take into account the new factors and problems that have entered the economic picture in recent years — especially those of ... the movement towards less consumption and zero growth. Perhaps I should add to my list the widespread public mistrust of Wall Street as a whole, engendered by its well-nigh scandalous behavior during recent years in the areas of ethics, financial practices of all sorts, and plain business sense.

— Excerpt from June 1974 speech by Benjamin Graham, printed in Financial Analyst Journal, September/October 1974

AUDI PARTEM ALTERAM

Hear the Other Side

The Boris-Kaplan Group // 1735 Market Street, Suite 1400 // Philadelphia, PA 19103 // T 215.563.2300
www.alexbrown.com/boriskaplan

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.

To subscribe, unsubscribe or to request back issues mentioned in this newsletter simply send an email to al.boris@alexbrown.com

Raymond James & Associates, Inc., Member New York Stock Exchange/SIPC. Raymond James is not affiliated with any companies mentioned. Opinions expressed in the attached article are those of the author and are not necessarily those of Raymond James. All opinions are as of this date and are subject to change without notice. Keep in mind that there is no assurance that any strategy will ultimately be successful or profitable nor protect against a loss. Investing involves risk and you may incur a profit or loss regardless of strategy selected.