

# PEP TALK OR REALITY CHECK

JULY 2008

This past May, at the Berkshire Hathaway annual conference in Omaha, Warren Buffet stunned many investors with his statement, ***“If a stock I own goes down 50%, I’d look forward to it. In fact, I would offer you a significant sum of money if you could give me the opportunity for all of my stocks to go down 50% over the next month.”***

Mr. Buffet has not gone nuts. He knows that he owns fantastic businesses. With that knowledge why wouldn't he want to purchase shares on the cheap before they return to their true intrinsic value. Benjamin Graham, the father of value investing, and author of the *Intelligent Investor*, taught that all asset classes have an intrinsic center of gravity, or worth. At times the asset will trade above that center; at times it will trade below. The thought process behind value investing is to buy when the asset trades below that intrinsic value. Simply put, there is an inverse relationship between price and value. The higher the price goes the value decreases, the lower the price, the greater the value.

I have beaten the drum for years, whether it is in my columns or on the radio, that more money is lost due to irrational investor behavior rather than asset allocation or even stock selection. *The Wall Street Journal* recently reported that \$39 billion was withdrawn out of U.S. stock funds, and \$6 billion out of exchange-traded stock funds.

Why?

If an investor is closing in on retirement and might need access to the cash in the next couple of years, I would understand completely. In fact, if that was the case they probably should not have been heavily involved in stocks in the first place. However, my experience and gut tells me that the inverse is true. I can smell irrational behavior a mile away, and my nose is telling me that there is something rotten on Wall Street. Unfortunately, many people that are in their prime saving and investor years are trying to guess what the market is going to do next. I am human too, when opening up account statements and seeing positions that are down in price is undoubtedly difficult to watch. I know it is not easy.

Warren Buffet made the astute point that investing is much like dieting: ***“It is simple but not easy.”*** Losing weight is simple, don't eat so much, and utilize that gym membership to a greater degree. However, when your mother-in-law is consistently trying to stuff you with tasty Greek food, it can be pretty darn hard. Quality, value, fundamentals and compounding interest are simple, but in volatile times where a faked photoshopped picture of missiles moves oil \$10, or really stupid comments made by a U.S. Senator from New York causes a run on Indy Mac Bank. Investors, whose financial plan is in order, need to remain focused on their goals not their account values during a financial calamity. One of our rules of the road is to think of oneself as a billionaire when investing. Wealthy individuals are not under any pressure to become wealthy; they already are. Wealthy people don't time the markets; they don't try to get rich quick. I have tried very hard over the years to get across the point that one needs to have faith in difficult periods in one's financial plan. It is utterly futile to invest successfully in a future of which one is fundamentally afraid. The big bad boogeyman for investors is fear.

The violent market movements that have occurred over the past 18 months remind me of a scene in the film *As Good as it Gets*, where Jack Nicholson's character (a famous writer) is asked by a voluptuous

blonde secretary how he could write about women so well. His reply, *"I think of a man, and I take away reason and accountability."* The markets right now are reacting without any rhyme or reason. If the CEO of XYZ Corporation happens to have a bad hair day, he risks a 10% haircut in his company's share price. Markets become irrational in the throes of all-out bull markets such as the dotcom fiasco and the real estate bubble. Uninformed investors sell their quality long-term assets to buy into fad. During the reign of bear or down markets these same investors sell those same high quality assets with the belief that the world is going to end. I am here to let you know that the world is not going to end, like other panics it only seems to be. This time is no different.

The media has called it. We are going into a depression! They said so, therefore it must be true. Much like their proclamations that Hillary Clinton was going to be the next president, Dan Rather's fake but true documents, the Y2K bug and many other tales of doom and gloom. Economist David Ransom stated quite succinctly, and taught me a new word when he stated in the *Wall Street Journal* that people tend to **anthropomorphize** (*big scrabble points*) the world around them. The media and Wall Street does this as well; things are horrid for them they assume that the same is true in all areas of our vast economy. The media unfortunately pushes the idea that every economic setback is new and different; a new horrible monster that is unprecedented in every way. Every time the crisis du jour passes, and the faithful investors are rewarded and the non-believers are punished.

Investors unfortunately are concerning themselves with the dangerous question of how does one trade these volatile markets? The question that investors should be asking themselves is whether or not they have a proper financial plan in place. If an individual has a goal oriented financial plan with a realistic time frame, do not concern yourself with ***"What is working now,"*** but rather, ***"What will work over time."*** The answer to that question is always, value, fundamentals and dividends. Tough markets call for faith, patience and discipline. Do not deviate or a heavy price will be paid.

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