

Market Commentary

Seesaw

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The stock market despite daily ups and downs, some of which have been in triple digits, is as of today about where it was at the start of the year. We commented in April about the tug of war between the positive factors pushing stocks up and the negative factors driving them in the opposite direction. That pattern continued in the third quarter and is likely to persist at least until after the election.

As we talk to clients and others there is clearly a sense of frustration with the lack of direction in stock prices. The question we are asked is what should an investor do in a direction-less market like this? We think the answer is pretty simple: sometimes the best thing to do is little or nothing.

Despite all of the talk about the need for a long-term perspective in managing publicly traded businesses and money, there is nevertheless a desire for short-term results. It is our belief this excessive focus on the short term has had a very deleterious effect on both. Publicly traded companies all too frequently eschew long-term planning in favor of producing quarterly earnings numbers. They do this because investors punish the stocks of companies that manage for the long-term but fail to produce short-term consistently positive results. This fixation on the short-term is in many ways a causal factor in many, if not all, of the corporate scandals of the past several years.

Similarly in managing funds too many investors and investment managers focus on doing anything possible to produce good quarterly numbers and in the process frequently make fundamental mistakes in judgement. Examples abound. When interest rates are low people are more willing to purchase lower credit quality bonds or extend maturities even though both can and frequently do produce losses in the longer term (when interest rates rise, longer maturity bonds fall in value). When dividend yields are low or good quality stocks are trading at premium prices, many venture into riskier securities with higher yields or seemingly better prospects for short-term capital appreciation. The latest quick return “story stock” has great appeal. Again, all too frequently this results in bad long-term investment decisions.

The saying “don’t just stand there, do something” resonates when it comes to many people’s desires and expectations regarding their investments. It is seemingly better to do something rather than nothing. The problem is that in many cases the best

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course of action is really to do nothing. We are reminded of the mania for technology stocks in the late 1990's. Patient investors in value stocks (among whom we would categorize our firm) were viewed as an anachronism because those stocks weren't doing anything while growth stocks seemed to have limitless possibilities. The end result was that far too many people changed their investment approach, increased risk, and paid the consequences in the bear market of 2000 through 2002. By practically any measure, over time value stocks have outperformed growth stocks. It is just a matter of taking a long-term perspective.

This is a market environment in which it pays to remember three things:

1. The lessons of the past should not be forgotten. Abandoning a sensible investment approach because it isn't producing short-term results will very likely prove to be a mistake.
2. Staying with a good solid portfolio and not trying to manufacture something where there is nothing should pay off in the long term.
3. Investment time horizons should always be viewed within a multi-year context. A 25% return in one year and a 1% return in the next (for example) still averages out to about 13%. Drawing conclusions from either the 25% return or the 1% return separately is a huge mistake.

While we are not averse to short term profits, we have always managed funds with a long term time horizon. There is little evidence that approach is less valid today than it was a year ago when stocks were up more than 20%.

October, 2004