The "Perspective for Investors" which follows was first published by us in very similar format as a Client Briefing in 1971. It is a compendium of our thoughts about the investment process, coordinated throughout with our philosophy on these matters. Securities markets appear more complex at present than ever before and dramatic events more frequent. A flood of new investment products has surfaced over the years to add to the confusion, and our conversations with clients over the years suggest you sense the real value to be gained by reviewing the basics. Much of what we talked about in 1971 has provided a sound foundation for our investment management activities and the main component of our counsel. We hope you will find it appropriate for review at this juncture.

PERSPECTIVE FOR INVESTORS

With the rapid social, economic and political changes taking place in this country and abroad, the art of investing has become more and more complex. The stock market has been increasingly volatile, and fickleness among institutional money managers has caused dramatic increases and decreases in both individual stock prices and in the general market. Such volatility, which could continue for some time yet, quite naturally makes individuals wary of common stock investments. In fact, individual investors have generally been rather persistent sellers of stock for several years. Yet, if individuals who tend to be somewhat more emotional than objective are selling, one must ask the question "who is buying?" For every share of stock sold is bought by someone.

To us, the answer must be either "fools" or intelligent, patient, objective investors who understand crowd psychology, who focus on value and potential, and who recognize how to take advantage of a negatively-charged market environment in which good bargains abound.

How then does one distinguish between the fool and the intelligent investor? Very simply – the intelligent investor shops for value and potential and the fool doesn't. Accordingly, it's our job in selecting stocks to concentrate on value and potential; conversely, we sell them when we determine that market price has outstripped the normal value and potential. One must do both to be successful.

There is no easy road to investment success – in spite of what some people say – and there are risks. But there are also great opportunities which are present most often when the risks seem the greatest. Conversely, the greatest risks exist when there seems to be no risk. In investing, obvious thinking, either positive or negative, usually leads to wrong judgments and wrong conclusions.

Why Do Stock Prices Fluctuate?

This seems like a simple question, but it's one which has not been fully answered after many decades of research and many tons of paper used in publishing various theories. The only completely clear conclusion is that they do and that these fluctuations are caused by supply and demand. When demand exceeds supply, the price goes up and visa-versa. We therefore need to be aware of what affects supply and demand.

Factors such as earnings, assets, dividends, corporate image, new products, and investor psychology (hopes, dreams, fears, etc.) affect supply and demand. Stocks become over-priced and under-priced relative to their basic values. But more important, investorpsychology is largely responsible for these swings. The successful investor will understand this psychology and take advantage of the fluctuations it causes.

Beware of Common Pitfalls

Lack of Risk Awareness. Almost everyone understands the risks of investing in new and untried companies, in companies with shaky financial structures, in companies in declining industries, etc. But it's amazing how many people disregard value versus price and consider investments in companies such as IBM, Eastman Kodak, AT&T, General Motors and DuPont as riskless. Nothing could be farther from the truth. Unquestionably all will probably continue to be great companies. But they are great investments only when the price is right. For example, there are many people who bought overvalued stocks such as AT&T in 1964 at $75 or General Motors in 1965 at over $100 a share and considered them riskless. But in 1970 with AT&T at $40 and General Motors at $60, we suspect they had changed their minds somewhat. As an investor, it is essential that you be conscious of price and relative value as well as quality.

Impatience. We all like to see our stocks move up soon after we buy them and continue to do so, but such is extremely unlikely to happen uniformly. So because most of us want positive action immediately we tend to over-trade, too often with unsatisfactory results. The grass is unfortunately not always greener. It is imperative to set a target for your investment. If it takes four years for a stock to double in value, your compound return has been greater than 18% – even if it happens after 3 1/2 years of watching your stock stand still or even go down initially. In making an investment one must always focus on the total return over time.

Inattention. It always amazes us how many investors buy stocks, follow them for a while, and then essentially forget them. Don't neglect your portfolio. Make sure you review it thoroughly at least once a quarter and ensure that your reasons for owning individual stocks are still valid. If you have neither the time nor the inclination to do so, let a reliable professional do it for you. More money has probably been lost by investors through neglect than through any other cause. The old saw about "salting away your stocks in a safe deposit box" is absolute nonsense. Make sure that doing nothing with your portfolio is a conscious decision.

The Lure of Inside Information. We have seldom heard a "hot tip" or bit of "inside information" which didn't sound intriguing. Many people can't resist the lure of speculating on such information. But you will be far better off if you act on none of these suggestions. Useful inside information is seldom given away in an accurate and unpolished form. Rather, most of it is third, fourth or fifth hand and usually has been embellished at each step along the way. Much more often than not, investments made on the basis of so-called inside information with little note of underlying values will cost you dearly. The odds are just too long.

Undue Concern About Taxes. No one relishes paying taxes. Yet undue concern over taxes influences many people to make more poor investment decisions than we care to think about. So many times, we see people put off effectively closing out an investment which is fully valued at a good profit because of the prospective tax liability. In too many cases, the value of that investment erodes to a point where the profit (and tax liability) has evaporated. Always remember, taxes are paid only on profits and, trite though it may seem, profits are always better than losses.

How to Avoid the Pitfalls

Know Thyself. Our own emotions (fear, greed and hope) are perhaps the most difficult obstacles one must confront in the market. They are always present in one form or another, in all of us, whether we care to admit it or not. Collective fear causes markets and individual stocks to fall too low while collective greed can push them up too far. Hope certainly does not have the negative connotation of fear and greed. Where would any of us be without it? But in investing, hope must be reasonable and objective, and it must be recognized as an obstacle when the facts clearly do not warrant it. Hope can paralyze. It can make us do nothing when we should do something. Never forget that fear, greed and hope affect us all and tend to make us do the wrong thing at the wrong time. We must consciously try to recognize these characteristics in ourselves and in the investing public and be willing to counter them by acting on the facts, regardless of the strain on our psyche or stomach.

Consider the Possibility of Being Wrong. No one makes an investment with the thought that he may be wrong. But wrong he may be, particularly in timing. Unforeseen problems occur in most companies and while many have the competitive position and financial strength to cope with them, many do not. Make sure that you concentrate your investments in companies which have strong assets, a proven operating capability, and whose stock is selling at a reasonable price. Doing so will, in the long run, help you achieve far better results far more consistently and, perhaps more important, will help protect you from permanent loss of capital.

Seek Competent Help. This is perhaps your most important job as an investor and one of your most difficult ones. Always remember, you will be dealing primarily with an individual, not just a brokerage firm, a bank, or some other institution. Traits you should look for are intelligence, imagination, maturity, sound judgment, and a genuine concern for your best interests. With sound investment help and with an understanding and application of the principles outlined here, you should be able to meet successfully your investment objectives over the years.