



## With Investments, Time Teaches Well

Remember the thrill when you made your first trade and the excitement with which you followed it UP? Or, hopefully not, the disappointment as you followed it DOWN? And then, how, through the first few years of ups and downs – which, by the way, have happened to even the best of investors – you slowly learned to rein-in your emotions and dissociate them from the market. It's what I call *seasoning*... think of it as experiencing all of the *seasons* of the stock market, directly in your own portfolio, over a span on time, and it wizens you to the market over time. Well, that's what I broadly plan to touch on today – that success in investing is more than looking at prices jumping around on your computer monitor, more than a sexy story or puff piece, but a skill that is developed over time and by avoiding folly.

I'll touch on three topics.

### Even the experts miss corrections and crashes

Consider the anticipation of a market crash, that great destroyer of portfolios. Well, I recently watched an interview of Yale economist Robert Shiller where he said that experts have always missed big events like market crashes. Think about it... in hindsight, the housing bubble and the crash in 2008 seem so obvious, yet most experts missed it despite loudly flashing warning signs - easy-to-get loans, zero down financing, blatant overbuilding and unbelievable gains in home prices.

Shiller, for one, did predict both, the dot-com and the housing crashes, where he was influenced by behavioral economics, a topic I have covered many times on past shows. Shiller believes that nowadays, there is too much focus on analysis and statistics but the problem is that world changes can't always be easily quantified or accurately built into a model.

But let's face it – no one wants to listen to the guys who talk about the risks of getting overly drunk when the party is raging and no one likes the guy who tells us to stay away from the punch bowl – so for every naysayer, the financial media typically trot out ten who encourage us to party on. And, surprisingly for me, this was not too long after the dot-com crash in 2001 – so I have always wondered why even the experts don't get it – these guys who've been steeped in the market for decades and have seen bubbles come and burst not once but several times. So I'd urge you to heed the signs of an overheated market and prepare yourself to anticipate down cycles and, more specifically, those crashes that we seem to get with increasing frequency and magnitude nowadays.

To give this a geological analogy, the frequency and magnitude of portfolio-destroying stock market quakes appears to be growing, perhaps because of derivatives, high use of leverage, computer-based trading or whatever – so you’ve got to prepare yourself even more to survive them.

### Don’t throw good money after bad

Now, another trap that investors fall into is throwing good money after bad. Here’s how it happens: say you bought a stock at \$30 and it’s now down to \$10. You’re probably chagrined by your loss and eager to at least break even... so the thought that naturally comes to most folks is a degree of over-confidence in their own abilities where they believe that they’d done their research really well and that the stock’s likely a bargain at \$10. But remember, your natural logic only holds true if the underlying business continues to be healthy and a drop in shares is merely the empathetic result of a broader market collapse, where even solid stocks get hammered. And, in fact, I personally know of many who continued to buy Lehman Brothers shares as it was collapsing... and, of course, lost lots of money in the process when Lehman quickly went bankrupt and its shares became worthless - simply because the underlying fundamentals of Lehman had collapsed. So when the market presents an obvious buying opportunity on even shares that *you think you* know like the back of your hand, be truly smart and have the discipline to re-do your research in an unbiased manner - dig even deeper when shares fall and only buy if those shares are a bargain. And make sure you understand the financial of the company you are going to own. In the case of Lehman, it was practically impossible to see what they were doing under the hood.

Additionally, investors commonly do two things when shares drop significantly from where they bought them. They either abandon that stock all together (which is such a waste) or they double-down and buy more without doing their research. And my advice to you is... do your research and then make an informed decision.

### Be cautious of narcissistic CEOs

Another thing you learn with time is how to sieve good management from bad. It’s always a good idea to thoroughly examine the man at the helm – the company’s CEO. There happens to be research by two professors from Penn State which shows that narcissistic CEOs are *value destroyers*.

The research looked at subtle tell-tale signs like the size of the CEO’s picture in the annual report, (I’m not kidding about this) the number of times a CEO was mentioned in a press release, how often the CEO uses the first-person singular “I” in public comments, the gap between the CEO’s pay and the second highest paid employee, the lack of a succession plan,

They found that narcissistic CEOs spent more money than average on questionable *pet projects* and made acquisitions at significant premiums, and that such companies displayed a high degree of volatility in quarterly financial results with gravity defying performance inevitably followed by gravity embracing collapses.

For example, if you look at Microsoft's acquisitions under its current CEO, Steve Ballmer, you may gain a few insights into why its stock has essentially gone nowhere...

- its 2007 acquisition of aQuantive for \$6.6 billion where, sometime later, a big chunk of the acquired company was later sold for just \$530 million
- the 2008 acquisition of Greenfield Online, only to later sell the main asset for under \$100 million
- its \$1.2 billion acquisition of FAST Search & Transfer at a 42% premium only to have FAST's offices raided for fraud investigations 10 months later, or
- its 2011 acquisition of Skype for \$8.5 billion.. we'll see how that goes but the track record isn't so great.

On the flip side, if you look at Steve Jobs and Apple, Jobs was rarely on conference calls, did not insist on being in press releases, had a successor in place and, very importantly, surrounded himself with smart people.

My hope is the thoughts I just shared with you will encourage you to now look at CEO quality as you evaluate stocks to buy.

So be cautious with your investments – be **very** cautious, and heed the three points I just spoke about to better weather potential quakes in your portfolio.

So you see it's a lot more than trying to chase numbers jumping around your screen. You have to know the fundamentals. There is no substitute for knowing what you own.