
IDEAL, ORDEAL AND NEW DEAL

The other day I was listening to a radio broadcast on the topic of marriage. A gentleman was being interviewed about his marriage. He said, “I came into it looking for the ideal, it became an ordeal and I found myself wanting to look for a new deal.” As we finish the first quarter of 2007 in the investment markets, his thoughts should encourage us and help us develop clear thinking about our investments.

Remember how perfect we all thought marriage was going to be before we were married? Our future spouse was attractive, interesting and working double overtime to please us. When we were dating, my wife made the most spectacular homemade pizza I have ever eaten. I assumed I would get to eat it monthly for the rest of my life. I wrote passionate and romantic letters to her when I was away at college and she assumed that it was preview of life-long attractions.

Then a funny thing happened on the way to the “ideal”. We had five kids in the first eight years of our marriage, bought a house (took on a mortgage) and quickly pushed each other farther and farther down the attention chain. They say that maturity is pursuing the needs of others at the expense of your own. All the balls that you juggle in these years can easily become an ordeal if your priorities and attitude are allowed to view things that way.

Much like the gentleman on the radio, many folks get deeply into the ordeal of marriage and begin to imagine that the “grass is greener on the other side of the hill” and they want to look for a new deal. The studies show that they are

not only likely to find another ordeal, but are more likely to have the second marriage fail.

The stock market can be very much like marriage. We all come into it seeking the ideal, which goes something like this. Historical statistics show that in the past stocks have produced an approximate 10% return between appreciation and dividends over very long stretches of time. We are attracted to that return because our financial life will work much better if we earn high returns on the money we have set aside for future needs like college and retirement. We are made aware of hot streaks among individual markets and/or hear about strong track records produced by certain money managers and mutual funds and fantasize about how great it would be for us to be part of it.

Once we become investors in the stock market, we soon realize and learn that above average results do not come in a straight line! Studies show that there is a one in three chance that you could do poorly your first year in the stock market and if you get particularly unlucky and enter at a temporary high point your stocks could struggle for three to five years. *At that point it looks like an ordeal. Remember, the great long-term results were predicated on participating for a long time.* Many studies have shown that 85% of the money made on appreciation is made in only 15% of the time spent in the stock market. Telling an investor about the ordeal before you start investing in stocks is like an older relative telling you before you got married that you were going to have to work at your relationship. *It sounds reasonable*

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until you have to do the work involved.

Everyone who invests for the long run ultimately gets involved in the ordeal/hard work side of investing. Every discipline has its cold stretches and studies show that those cold stretches usually follow three to five year hot stretches. At any given time there are asset classes or international stock markets that are hot and have produced above average returns for the prior three to five years. Those results look very attractive to someone in a long-term investment discipline which is “working through” a normal cold stretch. The bad news about the stock market is that 85% of the time is spent producing only 15% of the long term appreciation. In other words, you spend most of the time working hard, not eating homemade pizza and reading romantic letters. But just like many second marriages, the new deal ends up looking like the last ordeal, because the other disciplines recent success makes them look appealing.

Numerous studies have been done on the stock market and they have found that most investors put their money into a discipline right after a three to five-year hot streak for that discipline. We joked back in my early days as a stockbroker that “dogs chase cars, but people chase stocks”.

One study done between 1986 and 2000 among equity mutual funds showed that nearly 70% of the return that was there to gain by participating was lost because investors poured money in at high points and took money out at low points.

There are a number of new deals out there trying to attract our money. International investing, gold, oil, small caps, junk bonds and hedge funds are just a few. One of the most popular new deals at the moment is to try to “marry” everyone in the stock market. It is called asset allocation and it is designed to spread your money around all the major sectors

and/or international markets. The theory is that by having eight or ten investment “spouses” that there will always be a few who are producing superior results (the investment “ideal”).

To find out what’s wrong with that many investment spouses you need to watch a show on HBO called “Big Love”. It’s about a guy with three wives. All I have to do to appreciate my wonderful bride is to look at the expense and hassle he has trying to keep three women happy. Or I read the words of the smartest man to ever walk the earth, Solomon, who had numerous wives and concubines and shared his regrets in the book of “Ecclesiasties”. One long-term discipline is enough for me at home and in the stock market.

So how do you get the “ideal”? In a marriage I believe it has more to do with what you do than what your spouse does. Are you still making pizzas or writing romantic letters? Are you dreaming optimistically about your bright future? Do you focus on your spouses strong suits and ignore or laugh off the weaknesses? Try it and you may find yourself getting a lot closer to an “ideal” marriage. With your investments it has more to do with you as well. Above average returns come from long-term holding periods and requires that you ignore today’s fads; by so doing you can approach the “ideal” and achieve superior results.

P.S. — Try buying into sectors after they’ve been cold for three to five years and you could get off to a better start on your discipline.

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