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The King is Dead, Long Live the King!

The French are a unique people with a unique language. My mother's father and his ancestors originated in France and because of genealogy I like to feel a connection with them. They needed a way to describe current circumstances, just as we do as we look out to the year 2009 in the investment markets in the U.S. How they did that could give us some great insights into the future of our stock and bond markets.

The French say, "Le Roi est mort, vive le Roi!" The King is dead, long live the King. When the Monarch or holder of the throne would die, a new one would immediately rise up and replace the old one. The saying is designed to show the durability of the monarchy and the underlying strength in their country. As a Democratic Republic the U.S. does not have a monarchy. If we were a monarchy we would be observing the death of President George Bush's job title and acknowledging the hopefulness of succession to the Presidency of Barack Obama.

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The King of publicly-traded common stock wealth creation in the U.S. has historically been large capitalization blue-chip stocks. Their broad-based ownership and size caused them to create more wealth than higher return yet riskier and less widely owned investments. Buying and holding these companies has produced returns averaging 10% or greater over long stretches of time and did so while providing constant liquidity along the way. If you have watched T.V. (Mark Faber and Jim Cramer) or read the business periodicals lately, you know that many are saying that a strategy of buying and holding quality U.S. blue chip stocks is forever flawed and will never work again. The King of Wealth Creation is dead! Let's examine the logic behind those that believe the King of Wealth Creation is dead.

We don’t drive a car forward looking in the rearview mirror and we don’t think it pays to invest that way either.

The number one reason that some experts believe buy and hold is dead is because it just finished its worst ten-year stretch since the 1930’s. In this way the rearview mirror is being used for future advice. We don’t drive a car forward looking in the rearview mirror and we don’t think it pays to invest that way either. The second reason for giving up on buy and hold is the recent extreme volatility we’ve seen in the market experience. Their logic is that since things bounce up and down so violently in the short run that it makes no sense to own them in the long run. By encouraging trading they are intellectually dishonest, because they fail to mention that nobody can predict those violent swings or their direction. Lastly, most of the people who recommend avoiding buy and hold make their money from their professional activities like selling investment advice or from advertising or through entertainment or by transactions. They haven’t been made independently wealthy by their own investments.

Warren Buffett is the poster child for large-cap buy-and-hold investors and we know what he has been saying lately. In an Op-Ed piece in the October 17th edition of the New York Times he wrote, “Buy American, I am!” Let’s look at how Warren Buffett views the logic of the buy and hold naysayers. First, he would say, and did say in the op-ed piece, that the poor performance of the indexes these last ten years could lay the groundwork for superior positive performance for buy and hold over the next 5, 10 and 20 years. “You pay a very high price for a cheery consensus,” Buffett writes.

Buy and hold investors like Buffett believe that the extreme volatility of the market is the friend of the buy and hold investor. If you have your eye on a wonderful company and a certain price at which it is attractive for you to buy it, the volatility might just put you in the driver seat. There are many companies we at SCM are researching currently that we haven’t owned before but are now open for consideration because of this major decline and the volatile way it has played out.

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Many individuals are listed on the Forbes list of the 400 wealthiest Americans because of buying and holding large stakes in our blue-chip businesses. In fact, the buy and hold phenomena is so powerful that it reaches down through many generations. No Mellon family members are involved in managing the Bank of New York/ Mellon, but many of them appear on the Forbes list from their ownership of company shares.

You don't see Bill Gates or Roy Disney or Steve Jobs in advertisements or selling advice or doing a song and dance routine on T.V. They don't have to because they have held shares of a great company for many years through thick and thin. Long live the King!

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What does this all mean for the year 2009 and the following decade? We think that the single best time to believe in buying and holding quality U.S. stocks is when the fewest investors and experts have confidence in the discipline. Trust the durability and the staying power of our blue chip common stock monarchy. Shed your Treasury bills, CD's, Money Market Funds, Commodities, Hedge Funds and International Emerging Market investments and join us for what we believe could be major wealth creation. The King (Blue Chip U.S. Stocks) is Dead, Long Live the King! ■

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