Fall 2009

Investment Thoughts

This Issue

Dear Clients,

As the summer winds down (can Labor Day really be just around the corner already?) and the thought of school enters one's consciousness, we thought we'd hit upon two topics all students (and parents) can relate to: peer pressure and tuition bills.

We've all heard (or used) the phrase, "If everyone else jumped off a cliff, would you?" (It's second in popularity only to the adage about "walking uphill in snow to school – both ways"…) Resisting peer pressure is an important skill to learn in school; it is every bit as important to master when investing. Our first selection, from the *Wall Street Journal's* "The Intelligent Investor" column, delves into the topic and how it can impact one's investment returns. In keeping with the back-to-school concept, this is a test! As you read each of the main points the author makes, please ask yourself, "What will Chris and Greg have to say about this?" The answers can be found immediately following the article – no cheating!

The second piece is more straightforward. Studies repeatedly show that the greatest influence on how young adults view money is their parents; these same studies also show that parents greatly underestimate the role that they play. We believe the "Top 10 Money Decisions for Freshman" is a useful primer on the most common pitfalls one faces as he or she gains financial independence. However, its relevance certainly isn't limited to college freshman – it likely contains one or two points that we could all benefit from. We hope you find it valuable during conversations with the students in your life.

If we were administering an investment test to you, it would consist of one question: What is the purpose of investing? Whether your answer involves providing retirement income, meeting education needs, buying a new house/car, or leaving a legacy for others, it all boils down to one core principle: you invest to meet a goal. Our investment test is graded on a pass/fail basis, but by clearly defining that goal (How much do you need? When do you need it?) and maintaining a disciplined approach, you can pass your test with flying colors.

If anything has changed regarding the "what" or "when" of your investing goals, we want to know. Please, call us. Even better, call just to share that funny story or favorite picture from your summer adventures. We'll look forward to it.

THE INTELLIGENT INVESTOR

If You Think Worst Is Over, Take Benjamin Graham's Advice

By Jason Zweig

May 26, 2009

It is sometimes said that to be an intelligent investor, you must be unemotional. That isn't true; instead, you should be inversely emotional.

Even after recent turbulence, the Dow Jones Industrial Average is up roughly 30% since its low in March. It is natural for you to feel happy or relieved about that. But Benjamin Graham believed, instead, that you should train yourself to feel worried about such events.

At this moment, consulting Mr. Graham's wisdom is especially fitting. Sixty years ago, on May 25, 1949, the founder of financial analysis published his book, "The Intelligent Investor," in whose honor this column is named. And today the market seems to be in just the kind of mood that would have worried Mr. Graham: a jittery optimism, an insecure and almost desperate need to believe that the worst is over.

You can't turn off your feelings, of course. But you can, and should, turn them inside out.

Stocks have suddenly become more expensive to accumulate. Since March, according to data from Robert Shiller of Yale, the price/earnings ratio of the S&P 500 index has jumped from 13.1 to 15.5. That's the sharpest, fastest rise in almost a quarter-century. (As Graham suggested, Prof. Shiller uses a 10-year average P/E ratio, adjusted for inflation.)

Over the course of 10 weeks, stocks have moved from the edge of the bargain bin to the full-price rack. So, unless you are retired and living off your investments, you shouldn't be celebrating, you should be worrying.

Mr. Graham worked diligently to resist being swept up in the mood swings of "Mr. Market" -- his metaphor for the collective mind of investors, euphoric when stocks go up and miserable when they go down.

In an autobiographical sketch, Mr. Graham wrote that he "embraced stoicism as a gospel sent to him from heaven." Among the main components of his "internal equipment," he also said, were a "certain aloofness" and "unruffled serenity."

Mr. Graham's last wife described him as "humane, but not human." I asked his son, Benjamin Graham Jr., what that meant. "His mind was elsewhere, and he did have a little difficulty in relating to others," "Buz" Graham said of his father. "He was always internally multitasking. Maybe people who go into investing are especially well-suited for it if they have that distance or detachment."

Mr. Graham's immersion in literature, mathematics and philosophy, he once remarked, helped him view the markets "from the standpoint of eternity, rather than day-to-day."

Perhaps as a result, he almost invariably read the enthusiasm of others as a yellow caution light, and he took their misery as a sign of hope.

His knack for inverting emotions helped him see when markets had run to extremes. In late 1945, as the market was rising 36%, he warned investors to cut back on stocks; the next year, the market fell 8%. As stocks took off in 1958-59, Mr. Graham was again pessimistic; years of jagged returns followed. In late 1971, he counseled caution, just before the worst bear market in decades hit.

In the depths of that crash, near the end of 1974, Mr. Graham gave a speech in which he correctly forecast a period of "many years" in which "stock prices may languish."

Then he startled his listeners by pointing out this was good news, not bad: "The true investor would be pleased, rather than discouraged, at the prospect of investing his new savings on very satisfactory terms." Mr. Graham added a more startling note: Investors would be "enviably fortunate" to benefit from the "advantages" of a long bear market.

Today, it has become trendy to declare that "buy and hold is dead." Some critics regard dollar-cost averaging, or automatically investing a fixed amount every month, as foolish.

Asked if dollar-cost averaging could ensure long-term success, Mr. Graham wrote in 1962: "Such a policy will pay off ultimately, regardless of when it is begun, *provided* that it is adhered to conscientiously and courageously under all intervening conditions." (*continued on page 3)*

"The Intelligent Investor" continued from page 2

For that to be true, however, the dollar-cost averaging investor must "be a different sort of person from the rest of us ... not subject to the alternations of exhilaration and deep gloom that have accompanied the gyrations of the stock market for generations past."

"This," Mr. Graham concluded, "I greatly doubt."

He didn't mean that no one can resist being swept up in the gyrating emotions of the crowd. He meant that few people can. To be an intelligent investor, you must cultivate what Mr. Graham called "firmness of character" -- the ability to keep your own emotional counsel.

Above all, that means resisting the contagion of Mr. Market's enthusiasm when stocks are suddenly no longer cheap.

Chris and Greg's Take

Time's up! So, how'd you do? If this were an essay response, full marks would go to papers that included:

<u>Points of Agreement</u>

1. "Take Benjamin Graham's Advice" Indeed, Mr. Graham's book happens to be one of our favorite sources for pearls of wisdom about the market. Avoiding peer pressure in investing – being "inversely emotional" – is a wonderful piece of advice. A case in point: On February 24th, Chris read that the markets were experiencing a "crescendo of capitulation" as people sought to dump stocks. In retrospect, that was about the best possible time to be buying stocks.

2. Take the Long-Term View. While very few of us can take "the standpoint of eternity," it is useful to ignore the day-to-day. One of our favorite Ben Graham quotes is that "short-term, the market behaves like a voting machine, but in the long-term it acts as a weighing machine." Public sentiment and emotion, which can be erratic and prone to error, factor heavily in the day-to-day "voting" of the market (buying and selling). Over time, the fundamental value of a company (which is more stable and accurate) will win out. If your investment goal is many years in the future, don't get caught up in the day-to-day.

<u>Points of Difference</u>

1. Timing the Market. Simply put, we advise against it. While Mr. Zweig (the author) discusses two important elements of Ben Graham's philosophy (be inversely emotional and follow a disciplined, long-term plan), we would contend he gives priority to the wrong one when they come into conflict. Mr. Zweig implies in his concluding sentence that reacting to the market ("resisting the contagion of Mr. Market") is more important than adhering to a long-term plan (such as dollar-cost averaging). We would disagree because of…

2. The Influence of Emotions. Controlling your emotions is an incredibly difficult task, and investing is no exception. Mr. Graham's quotes in the above article illustrate this point. Increasing the number of active decisions you must make, such as evaluating whether stocks are "cheap" or not every month, increases the opportunities for emotion to derail your investment plan. A disciplined dollar-cost averaging plan (your monthly contribution through payroll deduction) becomes a routine act that you don't give a second thought. And, in the views of Mr. Graham, "such a policy will pay off ultimately, regardless of when it is begun, provided it is adhered to…under all intervening conditions."

This applies to getting out as well as getting in. If you know you will need money for college tuition (or a house, or a car) in a year or two, it's no time to say "but things are so great right now, Mr. Market says I should stick with it." Time waits for no investor – and neither do tuition bills, regardless of where the market is. If you have a known short-term need, set the appropriate funds aside.

We <u>cannot</u> predict what the market will do today, tomorrow, or even next week. We <u>can</u> identify what you will need and when you will need it. That should always be your primary concern (it is #1 to us), and if you proceed with that ultimate goal in mind, you may be the most intelligent investor of all.

Fall Newsletter

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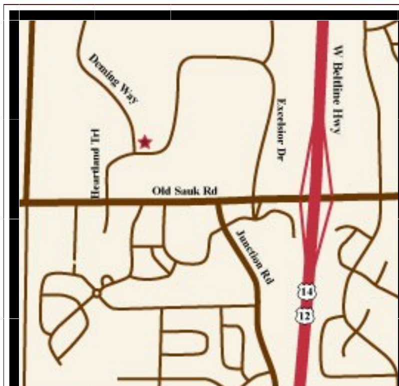

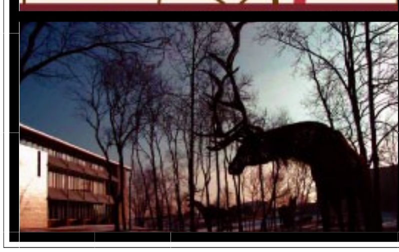

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