

# INVESTING INSIGHTS

## Calm, Relaxed and Focused on the Big Picture

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“How are you holding up in these crazy markets?” In one form or another, this question has been asked by countless friends over the years, especially when stock market declines are in the headlines. During declines, fears about future potential problems come front and center. Doom and gloom on the horizon is a sure way to get everyone’s attention!

In historical context, this year’s investment markets have not been unusually volatile. In light of the recent gyrations in the equity market, you might be surprised. This is because we think what happened yesterday is more significant because it is fresh on our mind. We forget that the past had as much or more volatility. In behavioral context, we conveniently forget the details of the past because we know the outcome of the events. The past seems less scary, because the knowledge of the outcome eliminates uncertainty. It is uncertainty that creates anxiety.

Investors are often anxious because the value of their holdings- stocks, bonds, real estate, etc.- is dependent on future events...and the future is uncertain! Ten years from now, the value of our portfolio will be shaped by the economic, political, regulatory and social circumstances of that time. These are complex issues and we know they will change. Predicting the changes is difficult- perhaps impossible.

So how do we create an investment philosophy to guide us through the fog of uncertainty and allow us to reduce the anxiety of market volatility? Here is a short description of my view:

- 1. ACCEPT UNCERTAINTY.** It is always with us. I don’t place importance on predictions...a sound strategy should not be dependent on them. The future has always been uncertain, yet the various investment markets have provided well documented returns and risks. Pay attention to those tendencies.
- 2. ACCEPT VOLATILITY.** In liquid markets, prices bounce around because some investors’ opinions change very rapidly, reacting to short term news which often is inconsequential in the long term. I prefer to base my actions on long term thinking rather than short term reactions. Eventually, good decisions get rewarded.
- 3. PREPARE FOR CHANGE.** Favor investments that deal best with an uncertain future...those that adapt best to changing conditions. This is the bedrock of my investment philosophy.

“ It is not the strongest of the species that survives, nor the most intelligent, but the one most adaptable to **change.**”

—Leon Megginson, Louisiana State University professor of business management.

## ADAPTING TO CHANGE

The economy is constantly evolving through a “creative/destructive” process. As new technology or business process is created and flourishes, it usually has a negative impact on the older, established business product or process. The evolution of the retailing industry over the past century is a good example. The “Mom & Pop” stores lining Main Street gave way to department stores, then strip shopping centers and discount stores, then huge shopping malls and big box specialty stores and then the internet and “virtual” stores. Almost every industry has experienced such evolution. Through it all, corporations evolved, prospered and provided broad investment opportunities.

I think of corporations as ‘living, breathing, changing’ institutions because they are run by ‘living, breathing, thinking’ individuals. The reason that businesses adapt, survive and prosper is that the collective wisdom and efforts of the employees drives them. Of course, not all businesses survive. However, new business entrants arrive to replace older businesses that failed to adapt. In aggregate, the business world keeps moving forward. Broadly diversifying our investments in businesses will shelter us from undue exposure to failing businesses. Most importantly, business ownership is the most adaptive of investment vehicles.

Public equities -owning shares of these businesses- has delivered the fruit of this adaptability, providing high returns over time. But these returns are coupled with short term volatility and occasional medium term set-backs. Our human behaviors are often propelled by anxiety or euphoria in ways that make the journey to investment success quite bumpy.

Armed with a diversified portfolio built to adapt to an uncertain future, we can relax our focus on the short term and have confidence that our long-term investment prospects are healthy. We know there will be some difficult periods in the journey. Our confidence in the long-term outlook is based on historical evidence and understanding of human behavior. We are ready for change...bring it on!

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