

ME AND THE MARKET

My mother played the market. She was a waitress who sent or helped to send two grandkids through college on her tips. What was left went into the market. She fell into the category of most investors—the 99% who invest in companies they know nothing about but depend for their information from friends, family members or the market gurus of the moment. In my mothers case the advice came from her daughter-in-law. But she had criteria. There were two. She never 1) paid more than \$15 for a stock and 2) insisted on the payment of dividends.

In this way she acquired a handful of blue chippers such as ATT, Ralston Purina, PECO, Chase Manhattan, National Semi, etc, and there were a couple funds of the index or value type.

For myself the market was a non-reality. I was aware of it but knew nothing about it or cared to find out. I had a business that I obsessed over and took the view that by definition only one obsession can be accommodated at a time.

At some point after many years of struggle I started to make money, a modest amount and it all went back into the business. From time to time I would write a check for a few bucks, \$500 or a thousand and hand over to my mother to invest on my behalf but this was more a

gesture—of my affection for her that I was unable to demonstrate in any other way (a long story)

Over time these small sums added up to \$15,000 or so.

Time passed and its 1994. Business was bad, very bad, I was 54, suffering from burnout and I packed it in--a tough call. I took a year off to play golf and consider my next move. My next move was to play more golf.

Meanwhile I met with my mother for a conference. The subject was money. The market was going thru the roof and had been for some time and none of this, believe it or not, had penetrated the world I lived in--a world circumscribed by the narrowest of boundaries. From time to time over the years she would say things to me like: "Ralston has announced a two for one split" or: "Chase has increased its dividend", or that "Lucent (a spinoff from ATT that I got for nothing) is going through the roof!"

So we had this talk and she turned over to me a vast pile of folders—of statements and annual reports and fund prospecti, ect, for me to take home and sit down with and to analyze. This I did and now I got a surprise—a nice surprise. The \$15,000 or so I had laid on her in dribs and drabs over the years was now \$100,000 or so. I perked up.

I decided to investigate this phenomenon. I read some books. They had titles like: *Neatest Little Guide to the Stock Market*, *Inside Wall Street*, *What works on Wall Street*, *High Yield with Low Risk*, etc. I read along and as I

did a glimmer of intuition gradually revealed itself. There was something about these books—a tone. It was the tone of a parent addressing a small child. It was facile and a little simple-minded and relentlessly upbeat—the cheerleader—or Oprah--concept. That was the glimmer of intuition that revealed itself: it cant be this easy.

But maybe it was. The market continue to climb. It was more than climbing—it was blasting its way into outer space.

I got the idea of making some trades. I called a friend, Hank, living in San Francisco, who played the market and had been for years

I said: “I have this money my mother made for me in the market. I want to make some trades. What do you advise?”

He said—and these were his exact words: “I advise you to call your mother”.

On with the books and I subscribed to *Money* magazine and *Kiplingers* and now each morning working my way through the paper I included the business section. I watched *Wall Street Week* and *The Nightly Business Report*. I had discovered something: the stock market was interesting.

I found a job—teaching ESL—English as a Second Language. I hammered Mexicans with verb conjugations. Not a bad job. The hours were short and I liked the

students. I took a test called the CBEST and got a teaching credential and latched on to the program at Los Angeles Unified where the going rate was \$37/hour. My short term financial problems solved, I was free to turn my full attention to the stock market.

On with the books. I read this one, that one, the other one. I learned a few things. I learned about the rule of 72—compound interest. It was Einstein, asked his opinion of the greatest mathematical discovery, who said: compound interest. According to the rule of 72 you divide into it the annual rate of return and that is the period of time required to double your money. The DOW historically delivers 11.7%. That means your money doubles every six years. You are 30 years old, you invest \$20,000 in an index fund and 18 years later at age 48 you have \$160,000. Now wait another 6 years. You get my meaning.

It was at this point I got stuck—the compound interest point. I was reading these books and picking up some of the lingo—the lingo of accounting, pithy expressions like gross margin, net income per share diluted, accrued liabilities, etc—but in the brilliant insight dept--nothing. I was looking for something—a system. There was no absence of systems. You had this system, that system, the other system. They were all over the place. But for some reason nothing registered. This nagging conviction prevailed—that these people, experts on the market, were all saying the same thing: buy some stocks and hold them—for but not for too long. That was the story.

I read a book called *The Money Masters*, a collection of interviews of some of the elder statesmen of the trade—Peter Lynch, Warren Buffet, George Soros, etc. The writer was John Train. By this time I had picked up a few certainties and at the top of the list was: to beat the market was easier said than done. Even for people making a living at it—the traders, brokers, fund managers, etc--it was pretty much a standoff. Sometimes they beat the market and sometimes the market beat them.

But here were these other guys— the Peter Lynch/Warren Buffet/George Soros types-- who were not only beating the market they were annihilating it. How? It was the view of John Train that an intangible was operating here—something all the experience and business savvy, the hard work, the reading and research and visiting of companies and interviewing of company CEO's and their secretaries and the guy who drove the lunch truck, etc—failed to explain. It was something else--that pretty much boiled down to the word "instinct". They had a "feeling" for the market. God bless the investor who has a feeling for the market.

I liked this John Train guy. He was coming at things from a different angle. He wasn't the Oprah type—the cheerleader type. He was objective, honest and even brutal—as in the feeling perceived one morning when—as certain as the air we breathe—you turn to the business page and your Lucent stock—your baby--has tanked overnight to the tune of 30%

That was Train. He called a spade a spade. They were hard words:

The stockbrokers preferred strategy is to buy apparently “underpriced” stocks from time to time and sell them when—and if—they become overpriced. Yet I doubt if today many investors, even professionals, exist who can do this with consistent success. Certainly the part time investor or retail broker has no hope of it.

The successful trader is an expression for which, like the unicorn, there is no corresponding reality.

The computer is a godsend in manipulating data but the day it relieves the analyst of the need for shoe leather, the plant inspection and assessment of management, industry knowledge and a lifetimes experience and flair will be the day the birds willingly fly up the barrel of your gun.

Time passed. It's the year 2000. Remember 2000? Remember march 2000? I remember because in January of 2000 I took \$25,000 from a value fund at Scudder that wasn't appreciating quite fast enough and divided the money in half and dumped one half into a tech fund and the other half into a large cap growth fund which was the same thing as the tech fund. I didn't stop there. I cashed in \$12,000 of my Ralston stock (my Ralston dividend paying stock) growing at a miserable 20% and bought 3 stocks: Lucent, Dell and Charles Schwab. I made a few

other moves similar to these and it was in this way I turned \$135,000 into \$75,000. And it didn't take long.

One of the things the amateur investing chump --the AIC, with a stock market IQ of zero--shares in common with other amateur investing chumps is that: when the market is going through the roof we can speak of nothing else and when everything turns and the market goes into one of its patented brutal plummeting nosedives into the toilet—we fall silent. Suddenly, in the blink of an eye, the market no longer exists. The word is a curse, never again to form upon our lips, nor are we to read a book, subscribe to a magazine, watch a business show on TV. The monthly and quarterly statements from funds and brokers are filed away unopened. That's the story.

Time passes—a couple of years. The market begins to recover—as it tends to do--and one day a statement arrives from the broker and you decide to take a look and when you do you've made some money—sometimes quite a bit. You perk up.

So it was back to the books, the magazines, the business section of the *Times* and the watching of gurus on TV

I read another John Train book: *Dance of the Money Bees*. It was written in 1972. It begins in this way:

Few people succeed in preserving their capital and even fewer will succeed in the future. One of

the Rothschilds said he would settle for preserving a quarter of his capital. Alas, he probably didn't make it. Survival is a competition. What you have, including your savings, others want and will struggle to get. The push to take it back from you is as relentless as that of the sea to overcome the dikes that contain it or the jungle to enfold a patch of cleared ground.

And this is Trains theme—not the making of money but the quaint notion of: how to avoid losing it. *Dance of the Money Bees* covers a lot of ground, but its the classic cycle of bust and boom—the Bull and the Bear and the raging unpredictable volatility of the market from which the title of the book derives.

The scientist von Fritsch studied the honeybee and this is what he found. When the honey bee locates a source of new blossoms the news is made known to the hive via a dance. The head bee hovers in space at a particular angle to the sun that serves as a guide to the blossom—the “beeline”

He now become quite agitated and thus begins his “dance”. Depending on the urgency of his motions more or fewer bees join in and off they zoom to the flowers.

That's the dance of the honey bee--that perfectly corresponds—as Train describes it--to the dance of the money bee—the average investing chump seduced by a bull market at the most volatile possible moment, or,

when he should be getting out, its now that he jumps in with both feet. How does this happen. Train says:

The herd instinct is powerful and occurs in every animal group. It is defined by a deep compulsion to behave in response to some signal or other. Greed is such a signal and so is fear and panic. The susceptibility to the contagion of mass emotion is one of our strongest traits and brought deeply into play during moments of major speculation. Who is not affected by the fear of losing everything he has, or the lust to have it double or triple?

This guy wasnt bad. There was wisdom here. He was a savvy dude--stock market-wise and there was something else: he was a writer. There was a voice here. I am a writer and what I look for in a writer is a voice. Most writers don't bother with this notion. They write like plumbers installing a sink—done pretty much the same way from one plumber to another. Down come the words onto the page, more or less as they feed into the brain and it is left for the reader to work out for himself any problems of clarity that may result. There is little humor and even less penetration of thought. Its as stimulating as a rock. Harold Ross, who found the *New Yorker* and served as editor for 25 years, was 10 years into the job when he had a revelation, revealed to EB White. He said: "Most writers don't know how to write".

But here I was, reading about things like profit margins and return on equity and price/earnings ratios, etc, and I had stumbled across that rarest of creatures: a writer. He

had a gift for metaphor, something not usually found between the pages of a book on the stock market.

I have chartered the consensus of newsletter writers and the result is they coincide perfectly with the least informed segment of the population: the odd lot short sellers. It turns out that if 60% of the subscription services are bullish, a significant decline is imminent, and conversely, if a mere 15% are bullish (that is, 85% are pessimistic), a major up-move is about to occur. That is the nature of markets. If all the kids jump on the one end of the seesaw because its supposed to go up—it cant go up.

Economists are like the Eskimos who sleep 8 to a bed. When one turns, they all turn.

There are such things as "tainted" stocks – gambling, tobacco, pornography, etc, and I note in this context a recent magazine piece devoted to a brothel company in Germany that has gone public with a lot of hoopla. But as Vespasian said, when he raised revenues for the state by taxing public privies, money is odorless.

Why the Bear and not the Bull—as a symbol for the crash? The explanation is this: to be impaled on the horns of the bull is a hideous fate but the word “carnage” doesn’t apply. Carnage occurs via the bear who first shreds you with his claws and then hunkers down to devour you with those yellow pointy choppers--a feeling

similar to the mauling received during a crash when within the blink of an eye you've lost half your money.

The cycle as described by Train works in this way. He begins just prior to the panic. The DOW is down by a third and many splendid issues have been cut in half. Unemployment is up, and some major international incident or act of God has chosen this exact moment to appear on the scene. The time is ripe for the herd instinct to kick in--with a vengeance.

There is a happiness that results from running with the herd—for good or ill—but mostly for ill. They are never so happy when they are all disappearing together into the toilet. You can almost hear it—this audible flushing effect.

Everything caves in during a few catastrophic days or weeks. Meanwhile a few of the pros—the real pros—the Peter Lynch/Warren Buffet/George Soros types—the ones with ice in their blood and nerves of steel--have been loitering on the sidelines in anticipation of this moment which somehow they but no one else, least of all the person who looks back at you in the mirror each morning, has foreseen.

We are at the beginning of a new bull market--a dynamic phase. This is where a window occurs--a buying opportunity--but it's a small window open only for a few months. Still the pros wait. They need reassurance the market has clearly turned. They are happy to pay an extra 25% for a stock that has been cut by two thirds to

be reasonably certain it is not going to decline by another 50%

Now they start to buy--snapping up the bargains-- some going for 10 cents on the dollar. Everything they buy goes up. There is no resistance because the sellers have sold and no one is left. They have the field to themselves. Its like shooting fish in a barrel.

Time passes. The market continues to move in this broad upward path. Now the herd, having sworn for the word "market" never to form again on their lips, begins to perk up. They observe timidly from the sidelines as all this action transpires and at some point, now that the window of opportunity has long passed, they spring into action--the bees in the hive responding to the dance.

The fervor and tempo of the dance continues to mount. The music plays louder and louder. Its a tumult—raucous. Now—yet again—we are all into the act and the prices are through the roof. Some sector or other--healthcare, biotech, financial services, etc emerges as the center of attention--the glamour stocks--skyrocketing even more than the rest into the stratosphere.

In 1999 I was in New York to attend a wedding, it was the height of the boom and the mood was euphoric. My Lucent I got for nothing as a spinoff from ATT had split twice and was about to again, hitting 80 with no end in sight.

I got into a cab and began to chat with the cabbie and I leave it for you to figure out what happened next. Correct. He gave me a stock tip.

Here is a passage from Train--written 27 years earlier:

You flag a cab, in a rush to have lunch with your broker. You chat with the cabbie, speaking of this and that, and the cabbie mentions a stock—Federated Fido that his nephew bought for 3 two weeks ago and is now up to 4. You tell the cabbie about Consolidated Canine which you bought yesterday and today is up 15%.

Time passes—a few months and signs appear among the mass of stocks--a hesitation slowing their upward climb. Only a few leaders continue to make new highs. In the papers the phrase, “loss of breadth” begins to appear. The ratio of advances to declines begins to dip—though the Dow remains high. Interest rates have yet to fall because companies are eager to expand.

Train:

In a boom beyond a certain level more business doesn't mean higher profits and it is at this point of the cycle that that fact begins to be noticed. A few enthusiasts claim that this time things are different and that the government—meaning the Fed--has mastered the business cycle. The Fed hasn't mastered the business cycle.

A few months pass and we start to recognize the typical top formation--a series of vicious chops. There is a first

chop over a period of several weeks, followed by a brief rally , then another chop, another rally and so on for a few months with each rally demonstrating less conviction and establishing itself at a lower level. The secondary stocks, the ones not in the leading averages have been sluggish for months. This is the beginning of the end, a dangerous moment. This is the time, according to Train, that if you sell out you will probably not regret it.

The stock market is an index of how investors feel about the future—not about the present. In other words, it's a barometer, not a thermometer. In a ship the worse the storm and the sicker the passengers the sooner things will improve and the barometer start to rise. Similarly once the weather is perfect, the next change in the barometer will probably fall. That's where we are now, with the barometer dropping and the passengers turning a little green and beginning to have misgivings about this trip they so blithely signed on for.

We are back where we started, the moment before the washout. We were down, then we were up, and now we are down again—rolling along with the market on on this devastating and exhilarating ride that began with panic followed by relief, then optimism, enthusiasm, euphoria, followed by concern, desperation, panic. The cycle is complete.

That's the story—a continuing story. I leave it for you to write the next chapter. But I would advise you to read

John Train. You can do it for the wisdom, the insight, the depth and range of his many interests and his business savvy and years of experience studying and thinking about--and playing--the market. Or you can do it for another reason. You can do it for the sheer pleasure of the writing—all too rare a pleasure.