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## **Fractured Fairy Tales: The Three Investing Pigs, or Frankly, My Dear, We'd Rather Own Norway**

Once upon a time, specifically in the early and mid-1960's, there were three little pigs. Their mother amassed a fortune through wise, rational investing. She knew, however, that while she tried to teach investing to her children, they would have to make their own mistakes. She gave them their stakes, bid them goodbye and wished them luck in putting together their own portfolios, warning them to be careful of the big, bad bear that, while not always visible, lurks in the woods.

The first little pig wanted his portfolio to be exciting -- while his mother's investments had been successful, they did not move rapidly day-to-day or even month-to-month. What is the point of investing if your heart doesn't beat a little faster when you read the stock pages in the morning? Fortunately, there were lots of financial service providers that catered to thrill-seeking, particularly since the rapid portfolio changes generate significant brokerage commissions.

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the entire market cap of Norway.***

So the first little pig started "momentum" investing, owning what's going up the fastest, regardless of the value. Momentum investing provided him thrills galore, for he was almost always invested in what people were talking about most. At cocktail parties, the first little pig could sound very hip, talking about how new technologies were changing the world. Oh, there was the occasional old fogey grouching about the questionable business fundamentals of his companies. The first little pig would point out that analyzing business fundamentals is the mating call of the loser -- after all, most of his investments had no earnings (and precious little in the way of sales), but they still had gone up more than anything else. In fact, they usually went up and down so much that when you looked them up in the paper, you didn't need to pay attention to those bothersome fractions -- just the integers, ma'am. (The first little pig's descendant today waxes eloquent about the Internet, and the old fogies are grouching about Amazon.com selling for more than the entire market cap of Norway. But then, the descendant points out, what does Norway have, anyway, but some ice, fish and angst-ridden expressionist artists?)

Of course, one day (in 1969) the lurking bear came out of the woods. Contrary to the first little pig's expectations, he didn't threaten to huff and puff. He just gobbled up the portfolio right away -- high-priced momentum stocks are like caviar to bears. The first little pig was right about technology changing the world, but his portfolio was still gone.

The second little pig, aware of his brother's debacle, swore off speculative investments of any kind. Instead, around 1971-72, he stuck to large, blue chip growth companies, the leaders of corporate America. Of course, occasionally someone would point out that these blue chips were now selling at record high multiples of earnings, book value and dividends. The second little pig knew, however, that his blue chip growth stocks would be around forever -- he might not make as much as a momentum investor in the short run, but his companies would be there in the long run, still growing sales and earnings. And besides, all the analysts loved his stocks and always wrote glowing research reports about them.

***Go figure -- blinded by the 80 percent decline in his portfolio, he was unable to see that he would catch up to the rest of the stock market in only 20 years!***

One day (in 1973 this time), the bear again came out of the woods. This time, he did threaten to huff and puff, for the valuation disparities between the second pig's large stocks and everything else had been noticeable for some time. Even when the bear started to eat his portfolio, the second little pig was secure in knowing he only held blue chips like Disney, McDonalds and Wal-Mart. One day in 1974, he noticed that those stocks had fallen 86%, 72% and 79%! His companies were still growing earnings, but investors no longer cared. Unable to endure the pain, he sold out near the market's low, his portfolio destroyed. The second pig's descendants today, buying the index blue chips, criticize him for not being a long-run investor. After all, he would have caught up to the rest of the market as soon as the early 1990's. While today's market looks a lot like the early 1970's, the descendants are sure they could lose four-fifths of their money with equanimity, knowing they are in it for the long run.

We don't have much to say about the last little pig. Frankly, he's a bit of a bore. He invested in a balanced, diversified portfolio. His heart never beats faster when he reads the newspaper, and he rarely looks up his investments, anyway. He's never been a big hit at the cocktail parties -- somebody, somewhere is always claiming to make money faster. He never gets greedy when the market goes up, but then he never got fearful when it went down in 1969-70, 1973-74, 1981-82, 1987, 1990 and the summer of 1998, while the portfolios of his brothers and their descendants were disappearing like barbecued ribs at a Mardi Gras party. He'd learned from his mother that successful investing depends more on managing emotions and expectations than anything else. Every bull market, the oh-so-smart novices criticize him for being stuck in the past. After every bear market, he's still there, achieving his goals.

If you want to be like the third little pig, contact us.