

What do you believe?

“I have a simple philosophy. Fill what’s empty. Empty what’s full.
Scratch where it itches.”

Alice Roosevelt Longworth

The quote above is credited to Theodore Roosevelt’s first child who grew up to become one of the most outspoken and quoted women of the century. Her philosophy on life is also a humorous analogy for what it takes to be a successful investor. We would like to take this opportunity to emphasize the importance of having a clear and simple statement of philosophy on investing.

Perhaps the only absolute truth in investing is that no one, but no one, can accurately and consistently predict the future direction of the financial markets, much less individual securities. Success and failure ebbs and flows for *all* investors. Faced with this sobering fact, the successful investor will adopt a disciplined philosophy toward investing. It is this philosophy that will be the foundation on which decisions can be made, even without knowing for certain the eventual outcome.

The following is what we believe.

Price matters for every stock. The stock market abounds with exciting stories. The obvious ones today are found in technology and Internet related stocks. After all, what is more exciting than the explosive and tempting growth of Internet and Internet related securities? The problem of investing in these stories is one of circular reasoning. That is, the more exciting a story is, the more investors have heard about it, the higher the stock goes, the more exciting the story is....you get the picture. ***We believe that a stock’s fair value is often different than the current price of the stock in the market.*** We look for good companies where we believe the fair value of the stocks are well above their current prices. A similar rule we live by is that a great company does not *automatically* make it a great investment.

Preservation of capital is as important as growth of capital. This is part of everybody’s philosophy...in a bear market. However, the true nature of risk is that frequently the danger is not realized until after the damage is done. Wise investors decide *before the fact* what the potential loss is in an investment and balance that against potential return. ***We believe each investment should be analyzed for its potential return and risk before deciding to buy.*** Too many investors in our opinion ignore the compelling math associated with loss of principal. For example, an investor who makes 50% in the first year but loses 50% in the second year has what return over a two-year period? (Hint: the answer is not 0%) (The correct answer is -25%.) This is a simple yet powerful argument why preservation of capital should be an important goal.

A long time horizon is critical to investment success. It amazes and concerns us to observe how short sighted the average investor has become. The investment industry’s marketing focus on low commission costs and trade executions that are measurable in seconds is partly to

blame. The result is an environment where many investors have become obsessed with trading. For example, America Online is the largest of the Internet stocks with a current market capitalization of \$162 billion. Over a recent 60-day period the cumulative volume of shares traded in AOL totaled 1.1 billion, equal to the *entire* share base of AOL. Regardless of whether you think AOL is cheap or dear at 332 times earnings (yes, you read that number right), it is easy to conclude that short-term speculators in this stock outnumber the long-term investors many times over.

Market history has a much different set of odds than apparently many investors have today. Using the S&P 500 as the market proxy, we would note that since 1960 the market has gone up 53% of the time while 47% of all days have resulted in a declining market. This is not much better than the odds of flipping a coin face up yet many investors today probably would guess up days are far more common than down days. Equally compelling statistics are that only 3% of all five year periods and 0% of all ten year periods have resulted in a negative return. ***We believe successful investing in stocks is much more likely the longer your patience.*** We also believe that the number one goal for investors is to find good stocks in which to invest. Finding the broker with the lowest commission cost or the fastest trade execution does not even come close to making the list of factors that should be important to meeting your long term goals.

By its very nature, an investment philosophy is highly personal and subjective. It is heavily influenced by attitudes toward return and risk. For example, a young investor with a high risk tolerance and a long time horizon may find the extraordinary returns and wild rides of the Internet stocks to be just the ticket. In contrast, an older investor with a low risk tolerance and a shorter time horizon will weigh more heavily the volatility of Internet stocks and minimize the opportunity of a blockbuster return.

Many investors today have also yielded to the experts to tell them the best way to make money in the markets. The truth is there are countless ways to make money (and to lose money) in the markets. You can be sure if someone had truly found the best way they would not share their secret with anyone else.

The implication of yielding your philosophy to someone else is clear. *You will never completely buy into any investment strategy with the conviction and commitment you need if it is not based firmly on the principles of your own philosophy.* A sound yet simple set of investment beliefs is all that is necessary to avoid chasing other approaches that are not suitable to your long-term objectives. If you cannot write down your investment philosophy on just one sheet of paper, it is probably too complicated or not completely thought out. And if you want someone else to buy into your advice or counsel, you should have a copy of your written philosophy on investing to give them.

So, what do you believe?

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