

# Thompson, Siegel & Walmsley, Inc.

INVESTMENT COUNSEL

Sports provide useful metaphors for many areas of life, including investing. Baseball, with its wealth of history and its mountains of statistics is a particularly good source of useful lessons for investors. This fall, we were treated to some compelling baseball as well as reminders that improbable events are far from impossible, that fundamentals usually mean more than omens, and that averages may be poor indicators of what is likely to happen next.

## **Red Sox, Blue Moon**

On July 31, 2004 the Boston Red Sox, bedeviled for 86 years by “the curse of the Bambino,” traded five-time All-Star Nomar Garciaparra, a Beantown icon, to the similarly ill-fated Chicago Cubs. That evening, with the Red Sox standing 8 ½ games behind the New York Yankees in the American League East division standings, a full moon rose over Boston for the second time in July, a so-called “blue moon,” believed by the superstitious to portend magical happenings. Boston old-timers, accustomed to late season disappointments, probably noted the astronomical sign with apprehension.

Following the arrival from Chicago of shortstop Orlando Cabrera, the Red Sox went on a remarkable tear, winning 42 of their final 60 games, and easily claiming a spot in the playoffs. Boston made baseball history by beating the Yankees after falling behind 3-0 in a best-of-seven playoff series to claim the American League pennant. The Red Sox crushed the St. Louis Cardinals in four games to win their first World Championship since 1918, Babe Ruth’s last full season with the team. During the final World Series game, on October 27, the full moon passed through the earth’s shadow, creating a rare total lunar eclipse. This confirmed, in the eyes of Red Sox fans, a magical end to the ancient curse.

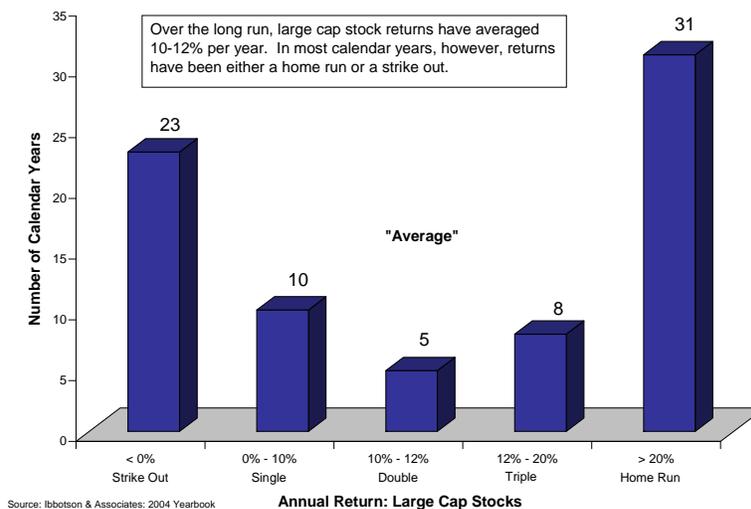
These events make great material for baseball folklorists, but a statistician would take a less romantic point of view that might also contain useful information for investors. Some events, such as lunar eclipses and “blue moons” occur in highly predictable cycles and are not as “rare” as you might think. Others, like World Series victories or rising stock markets, happen in patterns that can seem to be maddeningly random. Most investors, for example, are familiar with the notion that stocks produce *average* annual returns in the 10 – 12% range. The truth, unfortunately, is that markets can go through extended periods that are anything but average, and that market cycles can be difficult to perceive.

## **Hitting for Power**

Reggie Jackson, ninth on baseball’s all-time home run list with 563, is also the game’s strikeout king with nearly 2,600 career whiffs. The list of strikeout leaders is peppered with big hitters, including Sammy Sosa (7<sup>th</sup> in home runs, 2<sup>nd</sup> in strikeouts) and Barry Bonds (3<sup>rd</sup> in home runs, 10<sup>th</sup> in strikeouts). The stock market often exhibits this all or nothing tendency, as well. Although the mean return for nearly 80 years is in the 10-12% range, returns have actually fallen in or near that range in only five calendar years since 1926. “Home run” years, when stocks returned more than 20%, and “strike outs,” when stocks posted losses in a calendar year, have been far more common (see Fig. 1, next page). Investors should be aware that what is “normal” for the stock market, is usually anything but “average.”

Figure 1

## Market Hits and Misses Since 1926



### Hitting for Average

Power hitters have always been the stars of the sport, even if they are much more likely to strike out than hit a home run. Even baseball purists would agree that a Singles Derby at the All Star game would not excite fans like the Home Run Derby does. But that popular view does not diminish the value of singles hitters. Ichiro Suzuki, the Seattle Mariner's all-star outfielder has collected 924 hits in just 4 major league seasons and broke the 84 year old single season mark this year with 262 hits. For investors, collecting singles and doubles by building diversified portfolios, avoiding concentrated bets, and piling up steady returns through dividends is a better long-run strategy than swinging for the fences. This is the equivalent of "small ball" as managers like to describe scoring through bunts, sacrifice flies, and stolen bases, tactics that require a command of the fundamentals. Helping our clients reach their goal is how we define winning and we are much more comfortable hitting for average, scrapping for runs and relying on good fundamentals than relying on the long ball.

### "It's like déjà vu all over again"

Yogi Berra, one of baseball's wise men, might have been speaking about investor expectations when he uttered this famous line. Investors endlessly repeat the same shaky justifications for unsustainable valuations and unlikely growth projections. The rampant speculation of the late 1990s is obvious today, but only with the benefit of hindsight. The punishing bear market that ensued, however, did not abolish indiscriminant buying any more than a history of free agent busts keep baseball owners from overpaying for the next high priced mercenary. In 2003 the lowest quality, lowest priced stocks outperformed higher quality issues. This year Google achieved a valuation reminiscent of the bubble years of the late 1990s. In just over 50 days as a public company, Google vaulted to a market value in excess of \$50 billion, ranking it in the top 50 companies in the S&P 500 and equivalent to the market capitalization of Merrill Lynch. Sound familiar?

### Less Than Six Months Until Opening Day

We now know that President Bush, a former owner of the Texas Rangers, will take the mound next April to throw out the season's ceremonial first pitch, rather than Boston's John Kerry. The stock market reacted positively to the Presidential election results, perhaps due more to relief over a decisive outcome than to the identity of the victor. But just as baseball quickly turns to the pros after the President's loopy first pitch of the year, the stock market should quickly turn its attention to fundamental trends now that the election has concluded. Thompson, Siegel & Walmsley believes that these trends point in a positive direction but we are realistic about how powerful these forces are currently. Falling interest rates, which have been carrying the team (stocks) for years may have finally reached bottom. Earnings have been the up and coming star for the market recently but here too the pace is difficult to sustain. At 162 games, the baseball season is long to some and short to others, but all would agree (Red Sox fans especially) that perseverance and mastering the fundamentals is how you win at the American Pastime. We are optimistic we have the right team for success in any environment and we are confident in helping you reach your goal.