THOUGHTS FOR THE WEEK

EVERYBODY LOVES A SALE, EXCEPT ON STOCKS

February 8, 2019

We're writing this on February 6th, and in the first 37 days of 2019 the S&P 500 has returned 9.2%, and international stocks (MSCI EAFE) have returned 7.8% (Bloomberg). Quite the turnaround from a chaotic last three months of 2018. If you have an answer for why the collective investor mood has shifted from fear to greed in such a short time – please let us know. We have no clue!

Which brings us to the question of why investors don't love stocks when they're on sale? In any other market you can think of – clothing, jewelry, cars, apartments, food – buyers flock to the word "sale" like seagulls to a spilt bucket of boardwalk fries. Most goods, and even services, are marketed at least partly on how attractively priced they are. And then you have "events", like Black Friday, Cyber Monday, Canada's Boxing Day, or China's Singles Day, where people fight, figuratively and sometimes literally, to buy – revved up by "unbelievable prices." Even some of our national holidays have been co-opted by "sales" – you can always find a deal on a grill, car, or mattress come President's Day or the 4th of July.

Not so when it comes to stock prices. Investors, for the most part, are allergic to "sales" on stocks. The stock market is one of the only market places we can think of where higher prices are lauded, and lower prices cause fear and anxiety. The tulip bulb mania in the 1600's, the dot-com bubble of the late 1990's, even the recent craze for cannabis stocks, are all evidence that higher prices create positive feedback loops, and that human nature – when it comes to stocks and investment assets – doesn't change.

Canadian investor Larry Sarbit, in a November 2018 article published in Canada's Financial Post, explored why investors seem to loathe low prices when it comes to stocks. He first looked at some of the differences between buying stocks and buying, say, groceries.

"Many investors already own shares, and do not like to see the perceived value decline. But unless you have no plans to ever buy again, that doesn't explain the reluctance to buy when prices are depressed," writes Sarbit. Yes, our thoughts too. If you regard stocks as an ownership stake in a business, and not little prices gyrating on a screen, then lower prices should raise your level of interest, not depress it. Many of our clients built operating businesses. None seemed to watch the price of their business on a daily basis. Rather when given the opportunity to invest – because they saw a market opportunity, or because competitors were stumbling – they often pressed the gas pedal.

Maybe, as Sarbit writes, it's because there are no advertisements when stocks are on sale. In fact, the opposite is probably more true – the "mouthpieces" for stocks, such as CNBC and the financial press, tend to hyper focus on the daily movements and rarely talk about the long-term potential for businesses to create value for their owners. This can be thought of as a form of advertising, but unlike any other "product", the message tends to correlate with the price – lower = beware; higher = great!

But perhaps Ben Graham's Mr. Market analogy tells it best. Graham introduced "Mr. Market" in his seminal 1949 book, "The Intelligent Investor." As Graham wrote, think of Mr. Market as your business partner, a partner who's wracked with emotional issues. Every day he offers to transact with you –

buying your share of the business or selling his. Most days he offers a fair price. But some days he's depressed, and terrified you'll unload your stake on him, so he offers a low-low price. Other days he's euphoric and sees nothing but roses ahead – and offers you a comically high price to buy his shares, worried you'll "steal" his future gains.

And thanks to Sarbit combing through the 1987 Berkshire Hathaway shareholder letter, the inimitable Warren Buffett has this to say about Graham's concept: "An investor will succeed by coupling good business judgement with an ability to insulate his or her thoughts and behavior from the super-contagious emotions that swirl about the marketplace. In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind."

No one is perfect, and it's easy to get swayed by the herd. And sometimes the herd is right.
But at times, when it comes to investing, and asset prices are on sale, the herd is dead wrong. Unlike that "cheap" gas station on the corner of Highway 11, there are rarely lines at the proverbial pump, waiting to save a dime per gallon. So as Sarbit asks, are you Mr. Market? Or are you excited about Black Friday sales when they pop up? We try to be the sale shoppers – it's a struggle and we don't always get it right, but our compass is pointed in the direction of the sale bin, looking for bargains.

Enjoy your reading and your weekend.

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