July 9, 2013

Staying Invested in a Powerhouse Bull Market

Why does it often appear that the stock market operates with subliminal intelligence? What is it in this daily fluctuation of prices that can drive us so quickly from optimism to sudden fear? The pattern seems to be that the market rises enough over a period of five months to arouse a cautious interest in owning shares. Then suddenly, in three weeks or so it plunges five or six percent, just enough to keep the would-be buyers on the sidelines.

If you read our investment letter to clients in early December, 2012, then you know we believe we have entered a major long-term bull market. It is our opinion that most stock prices will go much higher, and that this overall trend will extend for the next ten to fifteen years. You can find this letter on our website (www.sara-bay.com) in the tab "Newsletters." The title is Achieving Success while climbing the Wall of Worry. In that letter, we give several of our reasons for our belief in this major change in investment climate, so we will not belabor the point here. At that time, the Standard and Poor 500 Index stood at 1416. We said we fully expected the old high of 1576 to be surpassed, and to watch for it to happen. It happened on April 10th of this year, and it now stands at 1640 after a peak of more than 1680 in May.

It is a little sad that when the stock market is in an extended multi-year uptrend, things occur that keep most of us out. Bull markets have sudden drops that come out of nowhere and create sudden fear. The last major bull market which started in the early 1980s lasted almost twenty years until the year 2000. In that period the Dow Industrial average gained almost twelve times its value – from about 1,000 in the Dow to over 11,700. And . . . most people were on the sidelines. The majority did not enter the market until around 1999. According to Gallup, 62% of Americans owned stocks in the year 2000. Today that number is 52%.

If you asked most people what they think of Warren Buffett, particularly of his methods and investment performance, an overwhelming number would express admiration at his financial acumen, and tell you they would love to emulate his performance. Yet, in reality, they do precisely the opposite of what Mr. Buffett advises and wind up selling when he would be buying. Buffett loves pessimism, whether with respect to a specific industry, or just to the economy in general. He believes it produces opportunities. A quote from the famous man: "We want to do business in such an environment, not because we like pessimism, but because we like the prices it produces."

Economics professor, columnist, and author, Thomas Sowell, believes most investors engage in what he calls "stage-one" thinking. That is to say they see the crisis and the risks, but cannot see beyond that. Their stomachs take over, they cannot control their emotions, panic sets in, and well-developed plans are abandoned.

Perhaps if we made our investment decisions in an atmosphere of quiet study and deliberate thought, the results for the many of us would be dramatically different. Unfortunately, this is not the typical scenario.

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We are slammed by a rapid-fire barrage of negative news events from TV, newspapers, and over the internet. If we are not careful, we may be making a long-term investment decision on something that happened yesterday in Greece or Egypt. When markets drop, CNBC typically parades a steady stream of gloomy apostles glibly forecasting plummeting prices. Remember – CNBC's goal is to grab your attention and increase ratings. Immersing ourselves in a constant stream of negative news through TV and other media can be very destructive to our personal financial health. I have found that one of the best times to search for companies is the very early morning, sitting in front of my computer with a cup of coffee and a yellow pad.

In our opinion, there will be certain types of securities which should be avoided. If interest rates continue to rise investments in bonds will prove very difficult at best. Until recently, bonds have been in a 20 year plus bull market, so many people have been conditioned that bonds are a good value and represent safe holdings. Climbing interest rates will also put pressure on companies or industries which typically operate with large amounts of debt.

On the other hand, there are developments and industries which were in embryonic stages over the last ten years which are now emerging as viable and functional.

- ***Communication*** – We now contact friends and clients in Europe and the Far East, both quickly and easily, via visual, voice, email, or texting. The expense of doing this is minimal.

- ***Cars which use natural gas or electricity*** – While natural gas engines are being used in buses and short-haul truck fleets, we believe battery powered cars are the most likely candidates for individual use. Shorter charge times and a national infrastructure of charging stations must be developed. Tesla Motors is actively working on both of these.

- ***Solar power*** – The cost of Solar is becoming competitive with traditional forms of energy. Once solar crosses the tipping point of being cheaper than fossil fuels, there will be a boom in this market. Governments are actively encouraging investments in the renewable resources of wind power and particularly solar by offering tax credits and other incentives. This is powerful and should not be underestimated.

- ***3-D Printing*** – A huge achievement in copying, design, and manufacturing technology, objects are created using a CAD (Computer Aided Design) file. This can have massive impact by instantly printing parts or entire products. Medicine may be changed forever as new bioprinters actually print human tissue for pharmaceutical testing and eventually organs and bones. This is a breakthrough technology of mammoth proportions, with effects on energy use, customization, product availability, art, medicine, construction, and manufacturing. It will change the world as we know it.

In short, we are very optimistic with respect to the next several years. I will not attempt to enumerate all the reasons now. This letter is long enough already. The breakthrough in April to a new high in the S&P 500 effectively penetrated the old high made in the year 2000. That was 13 years ago. Thirteen years is a long time to go without making much money, so most people are conditioned to the idea that the stock market is not a great place to be. There is an enormous amount of money parked in bank accounts, money

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markets, and other safe havens. It will gradually begin to trickle into equities, but the majority simply will not participate in the bulk of the coming growth. They will likely remain unconvinced for years, even as the markets continue to rise. As a wise old market sage once said, “What is obvious to most people is obviously wrong.”

In bull markets, corrections of eight to ten percent or more are not uncommon. If you wind up selling at the first sign of trouble, you must ask yourself another question. How will I know when it is ok to step back in? Know this: at the next good buying point, the news will not get better, it will get worse. Consider the next ten to twenty years, and ask yourself a question: Will new inventions and developments stop, or will we continue to make massive strides in technology, communications, and the ability to produce more effectively and with less expense? Don’t be dissuaded or fearful by the sharp and quick drops which inevitably come along in bull markets. Just know that they will occur, especially in fifteen year plus bull markets. We believe that is where we are. Keep focused on the long-term trend. In the coming years there is huge opportunity in this economy and this stock market!

Sincerely,

Mike　　Ben　　Andrew

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