Bulls, Bears, Pigs and Dogs

The cliché "the early bird gets the worm" is a justification for getting up early — or is it? How did getting up early work out for the worm? "Your Waterloo" is a way of referring to your demise — but why? While the battle of Waterloo was Napoleon's demise, Waterloo represented a career defining victory for General Arthur Wellesley, otherwise known as the Duke of Wellington.

Investing in stocks is like that, only worse. Many of the clichés about investing are not only wrong, they lead investors to bad decisions. For example, stating that "no one has ever lost money taking a profit," which we have heard far too many times, can lead to high portfolio turnover and higher taxes. It can also lead you to sell your best stocks. In this piece, we explore investing clichés that we would like you to forget.

1) "Bulls make money, bears make money, pigs get slaughtered." — Similar to the example in our introduction, this cliché leads to higher turnover. The cliché is an indictment against those who hold on to their winners. Taxes on capital gains are paid when stocks are sold, but there are no taxable gains at all if the stock is left as part of your estate. High turnover can cause higher taxes. Our most important point, however, is that what you paid for a stock is not all that relevant (and perhaps completely irrelevant) in a tax deferred account. Having a gain or loss is not any type of an indicator that the stock is overvalued or undervalued. Stocks should be evaluated based on their financial performance or the prospects for the company's product or service going forward.

2) Farm animals seem to get a bad deal from clichés. Dead horses get beaten. Two birds get killed with one stone. Dead cats get bounced. And bad stocks are called dogs. Are those dogs worth selling? A recent study out of MIT indicated that investment professionals are bad at determining which stocks to sell. The time investors spend selecting stocks to buy is far more than that spent on the sell decision. Often, a stock is sold because it looks bad in the portfolio, showing a loss and reminding you of the bad decision to buy it when you did. That sort of thinking is emotional. Instead, the MIT researchers found that sell decisions made in conjunction with an earnings report tended to be better decisions. That is, a bad earnings report is a better signal than a poorly timed buy. Sometimes the stocks with gains are the ones that report bad earnings.

3) Speaking of bulls, the terms "bulls" and "bears" are sort of clichés themselves. Where did the terms come from? One response to an internet search attributes these terms to the fact that bulls thrust their horns up while bears swipe down. This is not true, which we know because the trader/writer Daniel Defoe wrote about bears in 1726 after the South Sea Bubble scandal. Bear traders were sometimes said to sell the skin before capturing the bear. That is, they get ahead of themselves in their analysis, leading to losses. In any case, the connotation is clearly bad. The "bull" term's origins are far less clear. We believe that the media's constant attention to labeling investors as bulls or bears leads too many investors to think that they should think of the market as something to get in and out of. We think investors should own stocks for long periods of time, perhaps passing them on to their next generation, and invest in stocks with which they are comfortable enough to do just that.

4) As this is our April newsletter, we can't ignore the well-worn phrase "sell in May and go away." This is an easy one. The statistics simply do not back up this theory of selling for the summer and buying back in the fall.

5) Analysis of investment thoughts and trades of Warren Buffett have become tiresome, or rather, Warren Buffett is a cliché. Mr. Buffett has not been a good stock picker in a long time. Most of his success came from one of two insightful strategies. The first was that he figured out that companies with good brands were undervalued because accountants only valued equipment and inventory, ignoring the value of the brand. The second is that he realized companies with large cash balances, like insurance companies, were excellent takeover candidates, knowing that the cash balances could earn better returns with his investment acumen. These are no longer secrets. His stock picks have underperformed for many years now for the simple reason that he got away from his strategies. Dexter Shoe, ConocoPhillips, The Washington Post, and the UK grocer Tesco were all notoriously bad investments for Buffett, and none was a large brand generating great cash flow.

6) "It's a stock-picker's market." — The danger in this cliché is that it implies there are certain markets in which you can pick stocks and easily "beat the market," and there are certain markets where you cannot easily beat the market. The overall market is a good investment, in and of itself, and we don't think it is such a bad thing to invest in the broad market. Over the last 20 years, the most commonly quoted broad index, the S&P 500, has grown by 6.2% per year, or about 8% per year with dividends. We happen to think that buying the 500 largest U.S. stocks is too simple of a strategy. We prefer to winnow out the riskier stocks, and to focus on companies with consistent revenue growth, profitability and balance sheet strength.

7) "Kicking the can down the road." — This cliché is another that makes little sense. If one comes across a can on the road, we'd think that few would choose to keep kicking it down the road for lack of decisiveness. But this is the predicament that investors put themselves in when they choose to raise cash or get out of the market. Given that stocks go up about 70% of the time, when you get out of the market out of fear or to take profits, you will more often than not find yourself in a position of buying higher than where you sold, or choosing to defer the buy decision ever further into the future. We'd rather adopt the buy and hold approach from the start.

8) While we are on the topic of procrastination, let's all laugh at but ignore many of Mark Twain's investment insights like "October, this is one of the peculiarly dangerous months to speculate in stocks, the others being [and he names all the rest]." Mark Twain was a great author, but he lost money on a magnetic telegraph, a steam pulley, on the Fredonia Watch Company and on railroad stocks. He lost so much money that in 1891 he was forced to move the family out of their Hartford home.[1] Celebrities are rarely good sources of investing advice.

9) "Even a broken clock is right twice a day." — It has been reported that there was only one famous investor who predicted the crash of 1929, and that was Roger Babson. Babson also predicted the crash of 1928, 1927, 1926, well, you get the idea. We have our own Babsons, such as Noriel Roubini and Jeremy Grantham. Bad news sells, and the media can always find an expert who can get you worried. There is ALWAYS something to worry about if you choose to do so.

We'd like to close by quoting some wisdom that we wish would turn to cliché. President Dwight Eisenhower once said that "what is important is seldom urgent and what is urgent is seldom important."[2] We think you should leave the investment worries to us while we develop a long-term strategy, both for your finances and your investment portfolio.

Sincerely,

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[1]Time Magazine, April 19, 2016, Richard Zacks.
[2]The Economist, February 27, 2021, How to Make Sparks Fly, page 11.