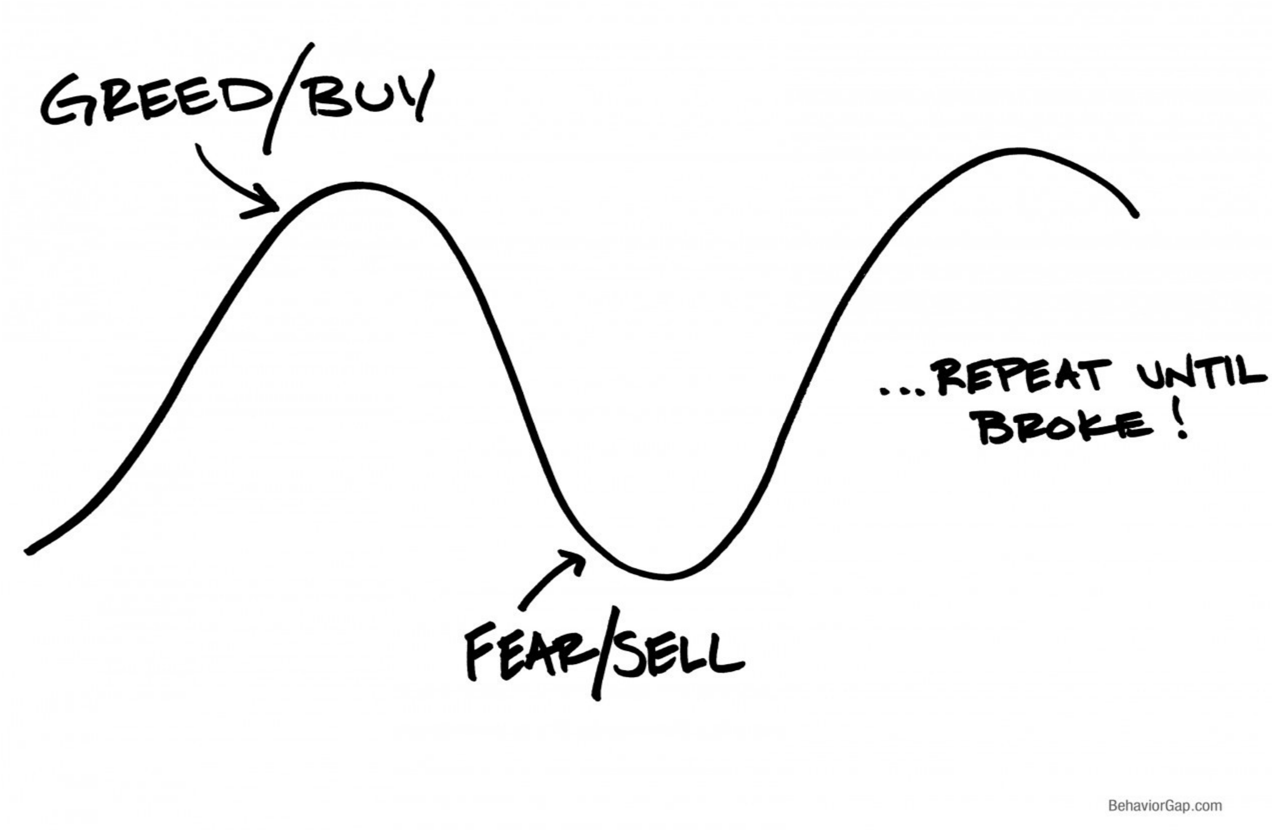
Head vs. Heart

By Trevor Macdougall



With daily headlines pointing to the fragile nature of the global economy, you'd be more than justified in feeling a little fearful these days especially considering that for many, the dark days of 2008 have still not been totally erased. The media doesn't tend to help, either. "The crowd" tends to move between the extremes of fear and greed over a business cycle.

There is an old saying that goes, "Some people know the price of everything but the value of nothing". This also rings very true when it comes to the world of investing. But, knowing the value of a particular business when others only see the price is something that you can use to your distinct advantage.

Awhile back we talked about the fact that your path to sustained investment success is found in your ability to NOT follow the crowd and instead make sound decisions. This can be hard to do in practice. The chart above depicts the typical emotional reaction that retail investors go through, resulting in poor results, frustration and ultimately a lack of confidence in future financial wellbeing. In this post, I'd like to offer you a strategy tip to help combat your potential emotional reaction and replace it with a more logical one that will ensure more success for you and your portfolio - helping to make you feel more confident in your financial future.

Price Is Not Value

Few investors truly understand the bottom line of long-term equity investing - growth in shareholder's equity drives share prices. What? In plain terms, the ability of a company to grow the amount of equity in the business per outstanding share over time is the bottom line that will determine the market value of the shares. An examination of a sound company's financials would reveal that each year the equity value of the business grows - both in aggregate and on a per share basis. So, it stands to reason that at any given point in time the equity value of the business can be ascertained. In other words, you can peg the value and make a rational case for what the market value should be.

In an emotionally charged environment, this is very valuable information. While other shareholders are potentially dumping their shares out of fear and usually a lack of knowledge about the value of the business they are invested in, you'll be operating from a place of knowledge that will help you avoid the emotional drive to sell an otherwise superb investment. Investors and advisors who understand this idea were able to act during the financial crisis of 2008 to acquire equity in some superb businesses at once-in-a-decade pricing. Fast forward to 2012 and the investments seeded back then will pay dividends (literally and figuratively) for years to come.

Make Decisions Based Upon Value Not Price

In my experience over almost twenty years, successful investors understand thoroughly the value of the businesses they are investing in. Decisions are made rationally based upon business-like fundamentals, while keeping emotions at bay. This allows these investors to remain invested in tough times thus increasing their ability to succeed and fund their longer term financial goals.

I hope this brief tip has you thinking about ways to improve upon what you're already doing. Please contact me here should you wish to discuss further. And, please consider passing this along to friends, colleagues or family who could use some additional advice.

Thanks for spending some time here. I hope to see you again next time...

Trevor

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