An Owner's Manual for Investing

" Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas."

— **Paul Samuelson** 1915-2009, Economist

In 1996 Warren Buffett wrote a brief Owner's Manual for Shareholders of his company Bershire Hathaway. In typical Buffett fashion he distilled complicated business principals into folksy wisdom that set realistic expectations for his shareholders. I have borrowed this idea from him and written a brief Owner's Manual for Investing, with a goal of helping you avoid common pitfalls that detract from long-term success.

I hope you will keep this piece and review it from time-to-time, particularly when markets are falling. – Pete

What is Investing?

Investing is thinking like a business owner. You invest in shares on the stock market but really what you are buying is part-ownership of a business. There are three main reasons to invest in a business;

1. **Growth** – You believe the business will grow in the future and hence should become more valuable.
2. **Dividend Income** – The business pays you an attractive sustainable dividend on a recurring basis.
3. **It is a Bargain** – The company is temporarily under a cloud or has a problem that you believe will be resolved over time. Currently the price of the shares is low to reflect the problem. Your investment thesis is that when the cloud passes or the problem is resolved, the value of the shares will go back up.

The best investments are those that contain a combination of all three of above elements. The key however to any of these approaches to investing is time, as it takes time to see growth unfold, receive dividends or wait for others to recognize value.

What is Speculating?

Speculating is buying something for no other reason than you hope that another speculator will come along and offer you a higher price for it. This practice is often referred to in investment circles as the Greater Fool Theory. Often you can end up being the fool in this scenario.

Let's connect

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Volatility

Volatility is best described as the day-to-day fluctuations experienced by the market. Price changes can represent a fundamental change in the outlook for a business, or they can be a reflection of speculator's view of the next twenty-four hours. Increasingly market volatility is a result of the latter.

Since speculators do not have an investment thesis, their investment time-horizon is very short-term in the hope that someone else will buy their shares at a higher price. As a result, they react strongly to the slightest glimmer of good news and they panic on negative news. Meanwhile, investors stay the course with the knowledge that the fundamental value of their investment is sound and is based on one of the three investment tenets stated earlier.

Like it or not, volatility has always been part of investing. An argument could be made that it has been magnified in recent years by computer-based-trading, which now accounts for over 70% of the daily volume on the New York Stock Exchange. Rather than shun volatility, successful investors learn to take advantage of it, buying when speculators are despondent and unloading their shares, and selling to the speculators when they are euphoric and overbidding on their purchases.

How to Manage Through Volatile Markets?

First of all, turn off the noise. Remember that newspapers and television programs exist to sell advertising, not help you retire comfortably. The stories they print tend to have sensational headlines. Sensational sells. Most solid, rationale investment stories are boring. And while most investors would benefit from this type of reporting, it does not help sell advertising for the media.

Secondly, the best thing to do when a crisis occurs is to do nothing. This is contrary to everything else we do in our lives as we are conditioned to react to crisis.

Finally, the best way to sleep comfortably through volatile markets is to construct a portfolio that takes into account the fact that there will be periodic downturns.

Here are some strategies for properly constructing an investment portfolio:

1. **Asset Allocation** – Set proper asset allocation targets that take into account your age and tolerance for risk and outlook for various asset classes.
2. **Buy Quality** – A broad market sell-off will reduce the price of all companies, however quality endures and once the crisis passes, the value of those quality investments will surface again.
3. **Focus on Dividends** – There are numerous reasons unrelated to panic sell-offs, for investors to emphasize dividend paying companies in their portfolios. However a further benefit of dividend investing is that during a sell-off you can continue to collect your dividends while you wait for the crisis to pass. This income will help you keep your focus.

Final Thought

There is one action you can take during a market sell-off that has been proven to add value over time: rebalance your portfolio. During a crisis, the equity portion of your portfolio falls in relation to your fixed-income assets. For example after a 20% correction in the market a balanced portfolio with a target mix of 50% equities and 50% fixed-income will now reflect 40% equities and 60% fixed income. If you were rebalancing back to the original target of 50/50 you should take 10% from the fixed-income side of the portfolio and add to the equity portion while the market is down. Successful investors build significant wealth over time by taking advantage of market downturns to rebalance their portfolios.

I hope you will keep this note, and next time the markets stumble and you are inclined to sell everything that you have, re-read it to remind yourself that you are investing toward a particular goal, not speculating on the most recent headline. If you would like to read Berkshire Hathaway Owner's Manual it can be found at **www.berkshirehathaway.com/ownman.pdf**.

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