FINANCIAL PREPAREDNESS

"One of life's most painful moments comes when we must admit that we didn't do our homework, that we are not prepared." ~ Merlin Olsen

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Mr. Market

A common mistake among non-professional investors is to equate the true intrinsic value of an asset with its current fair market value. The two are very different things. The key to successful investing is buying assets when the following ratio is high, and selling them when the ratio is low:

$$\frac{\text{intrinsic value}}{\text{market value}}$$

In a world of uncertainty, the human brain is desperate to glom on to anything that will provide definitiveness. In psychological experiments where people were asked to place a value on something, their answer was influenced by irrelevant but "available" numbers, such as their date of birth that they were told to write on the page.

Thus, you can imagine how definite and authoritative that current market prices must feel to investors as they appear in black and white on their computer, TV, or a monthly statement. The current market price is the value of the security. What kind of crazy person would think it could be anything else?

Benjamin Graham--the father of value investing, author of <u>The Intelligent Investor</u> and <u>Security Analysis</u>, and the employer and mentor of Warren Buffett—came up with the concept of Mr. Market: You come into an office every day and there's a coworker there named Mr. Market who is quite neurotic and is driven by the emotions of greed and fear. Every day he quotes you a bunch of prices for assets that he is either willing to sell to you or buy from you. Sometimes his quotes are reasonable, other times they're unreasonable (far too high or low), and occasionally they're just batsh*t crazy (like when my neighbor ran out of his house and yelled out, "Rob, I think Bitcoin is going to $1 million!").

Why is Mr. Market so moody? (It's ironic that my last name is Moody, because I'm a pretty stoic person, especially since I try hard to be that way when I'm investing.) First there are the over 100 known cognitive biases that prevent the human brain from making "rational" financial decisions (though most of them would probably be considered rational if made on the plains of Africa tens of thousands of years ago). Then there are the Modern Man maladies: insufficient quality sleep, the Standard American Diet, drugs (prescription, recreational and vaccines), lack of exercise and movement, lack of sunshine/nature/fresh air, television, social media, fake news, the decline of community and friendship, lack of self-awareness and mindfulness, a collapsing culture, corruption and fraud, political strife, riots and wars, the anomie of urban/suburban life. Anyone who constantly drenches themselves in that toxic brew is bound to be on edge.

When the quotes that Mr. Market offers you are not to your advantage, you don't have to do anything; you can just ignore him, just like you ignore other crazy and emotional people. When they are advantageous to you, you can act and take advantage of them. But if the quotes he offers you are significantly lower than the intrinsic value of your assets, that is no reason to become fearful or depressed.

Yes, if you decided to accept his lowball bids and sell all of your assets to him at once, you would receive his low offer price. But why would you do that when you don't need all of the wealth in your portfolio immediately?

Time tends to heal all wounds. The longer your holding period, the more likely it is that you will receive the return you expected when you bought an asset. So you never want to get yourself into a situation where you have to sell an asset (especially when Mr. Market is despondent and is offering only lowball bids) in order to raise cash to pay for your expenses.

Avoiding such a situation has two requirements. First, you want to own a lot of different assets that have low correlation with each other, which will give you a lot of *options*. (You always want to have a lot of options, which give you room to maneuver.) If you just own a stock index fund and a bond fund, technically, you're pretty diversified, but what if both dropped by say 40% and you needed to sell some shares to pay for expenses? You would have only two assets that you could sell.

Second, (1) you need a long time horizon (at least 20 years if you're investing in stocks), meaning you won't need any of that money soon to pay for expenses and/or (2) your portfolio needs to generate a lot of income. A long time horizon allows you to avoid having to accept Mr. Market's lowball bids, even if he remains in a funk for 15 years or so. And income from your portfolio allows you to pay for your expenses without having to sell anything to Mr. Market at a fire sale price.

My favorite form of income are dividends from stocks that have a long history of paying and increasing their dividend ever year. (Apparently, dividends were also a favorite of John D. Rockefeller, who said: “Do you know the only thing that gives me pleasure? It's to see my dividends coming in.”) When these stocks are held in a plain old taxable account, their dividends are taxed at preferential rates compared to distributions from a traditional IRA/401(k).

Financial markets have been very volatile this year, and they could become even more so, as I believe that the next financial crisis will be not only the worst in our lifetime but the worst in human history (due to rapidly increasing complexity and interdependence, unprecedented leverage, incompetent central planning, high frequency and algorithmic trading, historically rich valuations, and moral hazard). If that happens, Mr. Market will become almost suicidal and will offer nothing but rock bottom bids. So be prepared for that, and just remember that an asset's true intrinsic value can be very different from its current market price.

The current times remind me of a couple of quotes I came across last year: “Making peace with losing money is an essential step towards ultimately accumulating a lot more of it.” And “People who have low tolerance for financial pressure can never, and I mean never, be rich....The world will push you around. The world pushes people around not because other people are bullies, but because the individual lacks internal control and discipline. People who lack internal fortitude often become victims of those who have self-discipline.”

In conclusion, to be a successful investor, you have to be comfortable with uncertainty and the risk of loss. You have to be able to keep your wits about you when all hell breaks loose. You have to have a process (and the discipline to stick to it) that over time and on average will produce your desired result (instead of focusing on the current distressing results). The process is everything.

What You Should Be Doing Now

This week I continued to take advantage of the dollar's historic strength (I have a hoard of cash) and bought financially strong, highly profitable and value-priced dividend-paying stocks in Belgium, Germany, Israel, Japan, the Netherlands, Singapore, Taiwan and the UK, as well as more gold.

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I would love to hear from you! I thrive on feedback from readers. If you have any comments, suggestions, insight/wisdom, or you'd like to share a link to a great article, please email me.

Generally, I don't have time to answer questions about your specific situation, but if you have a general question that I think other readers also have, let me know and I will provide an answer in a future issue.

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Before starting a new diet or exercise regimen, you should consult with a doctor, nutritionist, dietician, or personal trainer.