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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Respect the Shorts

I've been a value investor for over three decades. Not only do value stocks have the highest return over the long term, they also have the least risk (unless they're a Value Trap) because they provide the largest margin for error.

There are lots of reasons to *not* buy stock in a company, including:

- management has made it clear that the goal of the company is not to maximize shareholder value
- it's not a good business (i.e., its long-term return on invested capital is below its cost of capital, or it's not consistently profitable)
- it's losing its competitive advantage (e.g., its return on invested capital has been declining)
- it produces a commodity (so can only compete on price)
- management is trying to defraud investors (usually by manipulating financial statements)
- it doesn't pay a dividend, or the yield is too low, or its dividend hasn't increased over time or was cut in the last year or two
- the dividend is at risk of being cut if the company has a bad year

- it's financially weak or isn't growing
- it's overvalued (due to high investor sentiment, artificially low interest rates, etc.)
- insiders have been selling a lot of shares recently
- political and regulatory uncertainty (e.g., clueless/utopian/kleptocratic people are in power)
- it's heavily regulated (e.g., utilities)
- its operations or balance sheet is opaque, or it's prone to imploding suddenly (e.g., banks)
- management spends a lot of time, money and energy on virtue signaling and interjecting the company into irrelevant political and social controversies instead of on maximizing shareholder value (management may be forced to do this due to pressure from fund managers Blackrock, State Street and Vanguard, even if they know it's imprudent and don't want to do it)
- poor management
- management is plundering the company
- it's too popular with investors and/or analysts (which means that it's probably fairly priced or overpriced, so little chance of an abnormal profit opportunity)
- low trading volume (so large bid/ask spread)
- it's a newer issue (so hasn't stood the test of time)
- currency fluctuations
- potential or current lawsuits

Due to the unprecedented conditions in which we now find ourselves (surrounded by a number of complex systems; massive intervention, currency printing, and manipulation by central banks since 2008, including artificially low interest rates that fueled a long global boom of malinvestment; the most amount of moral hazard ever; a national debt of nearly $32 trillion plus unfunded liabilities of over $187 trillion; a growing banking crisis; a possible real estate crash; the third most expensive stock market in the world; a hot war with Russia and a cold war with China; military failure and the replacement of warriors with social justice warriors; unfavorable demographic trends in the industrialized countries; high inflation and taxes; the destruction of small businesses and the middle class; economic malaise; an epidemic of crime, addiction, fatherless children, homelessness, and “disability”; the death of the work ethic and shortage of competent and dependable workers; the replacement of a meritocracy with an incompetocracy; corruption at the highest levels of government; rule by a permanent and unaccountable government bureaucracy; the Great Reset; deliberate sabotage of the U.S.; the end of the dollar as the world's reserve currency and a possible botched attempt at a central bank digital currency; and a fragile infrastructure that is at risk to hackers, foreign governments, natural disasters, etc.), it's especially important to be cautious and circumspect with any decision to buy an asset as an investment. We are in unchartered waters.

Five years ago, I read the book Essentialism, in which the author writes that “If something isn't a Hell Yeah, then it's a No.” I have embraced this philosophy when it comes to deciding what to invest in. I would rather have a portfolio of say 30 Hell Yeah stocks than own thousands of stocks (via index funds) that are Meh, unattractive, unreliable or sketchy.

When you track about 1,900 dividend-paying stocks like I do (there are thousands more stocks that don't pay dividends that I don't even bother to track), you have to have some heuristics that allow you to quickly separate the wheat from the chaff. One of the simplest I use is the Inside Owner/Short Seller ratio, where I compare the percentage of shares owned by insiders (employees and the board of directors) with the percentage of shares that has been sold short by short sellers.

As an investor, how can you ensure that the interests of management and the board of directors are aligned with those of investors? Easy. The greater the percentage of shares that are owned by insiders, the more their interests will be aligned with those of investors. If insiders don't own a significant amount of their company, then why should I as an investor own shares? It should come as no surprise that the corporations who signed the Business Roundtable statement that sought to redefine the purpose of a corporation away from maximizing shareholder value tend to have low insider ownership of shares, generally less than 1%. If insiders aren't shareholders themselves, it makes it easy to move shareholders from the first priority to the fifth.

I have great respect for short sellers and consider them among the smartest of the Smart Money. That's because their maximum potential profit is 100%, but their maximum potential loss is theoretically *unlimited*. Also, if the stock they borrowed pays a dividend, they have to pay those dividends to the owners from whom they borrowed the shares. And making profitable trades as a short seller can be even harder during a period of high inflation when nominal stock prices tend to rise simply due to inflation. So to survive as a short seller, you really need to do good research and be confident in your conclusions. I assume that short sellers know what they're doing, and don't trade against them. So if the percentage of shares held by insiders is less than the percentage sold short by short sellers, I don't buy the stock.

News Items

Corporate Suicide Run Amok: I thought David Stockman nailed it: “...the larger point. To wit, how to handle immigrants and so-called border security is a classic two-sided debate subject to a broad range of facts, interpretations and values. It is intended for the halls of Congress, therefore, not the decision calculus of deputy assistant marketing directors in corporate America. At the end of the day, it is no mystery as to how the likes of Dylan Mulvaney knocked what is now 21% off Bud Light’s sales with such alacrity when Coors and Miller have failed for years to nibble away even a fraction of that plunge; or why national advertisers have been taking a pass on the best rated news show on cable prime time [Tucker Carlson]. To wit, decision-makers in corporate America are so deep in Fed-enabled stock option riches that they are not resolutely attending to business and are allowing the ideological and political infatuations of their younger, wokish staffs to stand in the way of profit maximization. In a word, a corporation desperate for higher profits in order to earn a higher share price the old fashioned way through earnings expansion rather than PE inflation would have never put the...face of Dylan Mulvaney on a can of their beer....So what we need is a good old-fashioned stock market crash. In one fell swoop that would wake-up the corporate C-suites and trigger a massive purge of the woke staffs, operations and costs which are now eating away at profits and undermining corporate brands and assets."

Growing Pushback Over Blackrock in Ukraine: Now what is Larry Fink doing in one of the most corrupt countries in the world? He must smell some huge federal contracts. Will he hire Hunter Biden to serve on some boards there, given his experience?

Who Are the Elites Who Have So Upset the Middle Class? I came across this September 2016 column by Victor Davis Hanson, which completely explains Trump's victory two months later.

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Recommended Books
(I receive a commission if you buy a book via this link.)

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