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Thoughts for Investors

The Stock Market's Wind

Spring Client Letter 2022

“Human subtlety...will never devise an invention more beautiful, more simple, or more direct than does nature because, in her inventions, nothing is lacking, and nothing is superfluous.”

– Leonardo da Vinci

Indeed, nothing in nature is wasted. Gross as they may seem, even maggots have an important role as efficient consumers of dead tissue, leaving sound tissue unharmed. Over the centuries they have been used by humans to clean wounds. Napoleon is reputed to have used them in battle. Less gross, let's ask, what is the importance of wind? You might first consider the destructive capabilities of tornadoes and hurricanes or spreading wildfires. Focusing on the positive, everyone enjoys a cool summer breeze. As a forestry major in college I would add that wind disperses seeds and pollen.

“Notice that the stiffest tree is most easily cracked, while the bamboo or willow easily survives by bending with the wind.”

– Bruce Lee

Have you ever noticed trees with severely leaning trunks like palm trees on a windy island beach? Why don't they all eventually topple? In response to the wind, these trees grow “stress wood”. This strengthens the trunk or branches while allowing it to remain flexible. The moral is that wind is a part of nature, both destructive and beneficial.

Many years ago I read about environmental scientists' work on a “biosphere”, an ecosystem within a massive plastic dome. They struggled to keep trees alive past

the sapling stage despite all the proper amounts of water, nutrients and sunlight. The trees kept dying as diseases and parasites, natural organisms present on all trees, kept killing their hosts. Finally someone figured it out. No wind! Besides its destructive capabilities, wind plays a less understood role. It knocks out a lot of dead and diseased branches, allows for the creation of “stress wood” and improves a tree's overall health. Of course, if the tree is sufficiently rotted, even the grandest ones can be blown over, clearing a spot for the sunlight to feed a new generation of trees!

“A great wind is blowing, and that gives you either imagination or a headache.”

– Catherine the Great

So what does all this have to do with the stock market? Volatility is the wind of the stock market. We often don't really know where it comes from or where it goes, when it may start and why it stops. We only know its effect, “imagination or a headache.” Investors cursed volatility when it toppled investments in Bethlehem Steel, Eastman Kodak or Sears and it wasn't until Enron fell that investors understood how rotten it was. At the same time, the “toppling” of Sears made way for Walmart. Now even Amazon's branches are “shading” Walmart. Volatility is natural. Just as maggots and parasites have a job (some describe “short-sellers” this way, but we don't) volatility has an important role as a “wake-up call” or system of “checks and balances” on excesses. It can alert both investors and companies to issues they may not see or incorrectly choose to ignore. Volatility is not a perfect indicator.

It can beat up both healthy and unhealthy stocks, requiring investors do their homework to decide which is which.

Occasionally, a paramount example of volatility, a “bear market,” acts like a tornado or hurricane, somewhat indiscriminately affecting good and bad stocks. In reality, since bear markets are more infrequent than their climate counterparts, investors are often either emotionally unprepared for them or so prepared they are afraid to invest. Like the wind, volatility eventually calms and the sturdy yet flexible stocks that remain get the benefit of more “sunlight” and room to grow.

“Smooth seas does not a skilled mariner make.”

– English proverb

So, as investors, how should we prepare ourselves for volatility? First, understand and accept that like the wind, volatility will arrive and test your skill as an investor. The only way to avoid it is not to invest at all. You can decide if that is a feasible option for you. Don’t get unnerved that every breeze of volatility may turn into a hurricane. They don’t. Acting on every false alarm is like the boy who cried wolf. It’s not good for long-term investors.

“The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails.”

– William Arthur Ward

Second, use small breezes of volatility to develop your “stress wood” or tolerance. Every breeze does not require major changes. When the true hurricanes or tornadoes come you will be better able to withstand the real buffeting by becoming shareowners vs. shareholders. Shareowners are long-term investors (including employees and management). They understand why they own a stock (or they hire someone to do the work for them.) Be prepared for the “weather channel” (academia and the financial media) to bombard you with stories of past carnage and carnage to come. With an expansive and deep understanding of the long-term opportunity of a stock, and perhaps the “support” of an

advisor for when the inevitable mental buffeting arrives, owners are less likely to panic and sell than holders.

On the other hand, shareholders are short-term investors, similar to renters, traders and speculators. They typically don’t have a very expansive or deep understanding of the long-term opportunity. Instead, they often speculate on “big picture” macroeconomic factors such as the direction of interest rates, politics, energy prices or fads. They may occasionally be correct but are often simply guessing, the product of their “opinions”, and their successes are often not repeatable.

“To reach a port we must sail, sometimes with the wind, and sometimes against it. But we must not drift or lie at anchor.”

– Oliver Wendell Holmes Sr.

The final step is to seize the opportunity to add to good stocks when volatility arrives. Volatility, like the wind, will remove “dead wood” and create a clearing, allowing the sunlight to nourish your investments. It’s nature’s way. Your preparation, your “stress wood”, will strengthen you.

In summary, just as trees can benefit from the wind, so too can investors benefit when their skills are honed by volatility, the stock market’s wind.

“When everything seems to be going against you, remember that the airplane takes off against the wind, not with it.”

– Henry Ford

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