

Posted to the Gilder forum - November 29, 1999

Bulls, Bears and Chickens

We are all in a party mood. The world is bright and we are brighter because we are lit by the everlasting brightness of our Gilder star. But there is a nasty Law of Averages lurking out there waiting for the unwary. How many of us are prepared to meet the Law of Averages?

In one of my previous lives I used to sell life insurance. I was a failure in that business so I switched to general liability and there I did OK. As I look back I now realize why I was a failure. I used to tell the naked truth, not a shred of clothing to make truth decent. When I talked to a customer he would invariably say: "If I die..." and I would correct him: "When you die..." and for some reason that took me a long time to figure out, they refused to keep on talking to me.

So here I am again in Life Insurance Mode, telling you the naked truth: "The Law of Averages will catch up with all of us." "What will you do about it when it does?"

The Law of Averages tells me that since the historic growth rate of the market is about 12%, eventually the current euphoria has to settle itself down so that we can get back to the historic rate. As a matter of fact, it is quite possible that we might have a bit of a negative growth rate for a short while (there I go dressing up the naked truth so it does not catch a cold). It is quite possible that this time it really is different and that the bubble will never burst (now the naked truth is fully clothed!).

I have no idea if it will happen or when it will happen but it might happen, the bubble might burst. And my question is: "If and when it does, what are you going to do about it?" "How are you preparing yourself for this highly unlikely (still more clothes!) eventuality?"

I'll tell you what I am doing about it. I want to continue to use a buy and hold strategy because it has proven itself to be superior to market timing. My fear is that I might be scared out of this conviction when the market or my portfolio starts to drop like a stone (at one time, I lost 25% in 3 or 4 months!). Some time ago I calculated the minimum amount of capital that I should have to reasonably insure that I will never again have to work in my life. When the portfolio grows beyond this amount I can spend the excess. The excess so far has bought me a boat and a small apartment and has allowed me to live well. When the portfolio drops to this minimum level, I spend less and I work harder at beefing up the portfolio.

Since I perceive that the market and my portfolio are defying the Law of Averages and that it might try to bite back, I have decided to double this minimum requirement. This is no hardship because GG has helped me create, earn or find this extra wealth. But if and when the dread event comes, I'll be able to face it in a cool, calm and collected way. I will have banished (I hope) fear!

You might well say: "But you have not really done anything!" and you are, of course, right. But I will have prepared my mental attitude and I should be able to continue to use the buy and hold strategy.

Denny