Posted to the Gilder forum - May 21, 2001

Investing Fads

In investing like in most human activities there are fads, waves of this or that investing style. The latest fad to crest was LTBH which went out of favor after the techno-bubble burst in 2000.

LTBH has worked for years for Warren Buffett and for Peter Lynch but since the bursting bubble depleted 80% of the value of many holding now some people opine that LTBH is dead.

If you had bought techno-stocks in 1998 and 1999, most of them would still be above their purchase price even after an 80% drop from their respective tops. Take JDSU which I purchased on January 25, 1999 at 8.797 and which closed last Friday at 21.19 -- that's a 45.5% annualized gain which outperforms even Warren Buffett. Of course, if you were a newbie coming into the market in March 2000 on advice of your favorite cab driver (an apology to all cab drivers is in order here ;-) or the most popular techno-guru of the time, then you lost your money. But don't put the blame on the techno-guru or on the bubble, put it where it belongs, on your own greed, which made you forget a most important maxim: "If it sounds too good to be true, it probably is." Anyone who thought that 50 and 100% yearly gains in the stock market are the norm, was out to lunch.

Before you accuse me of using one particular stock that did very well, let me use my enemy's favorite portfolio, The WORRY FREE Portfolio. OK, I did some massaging: I dropped all stocks that were not public on January 25, 1999 and I picked the arbitrary start date, January 25, 1999 because that that was my first GTR purchase, JDSU.

Here are the results:

Ticker	1/25/99		5/18/01		Annualized % change
	Price	$	Price	$	
ALTR	14.531	1,000	27.850	1,917	31.98
AMCC	5.188	1,000	23.510	4,532	90.51
ARMHY	3.650	1,000	15.970	4,375	87.68
CSCO	25.859	1,000	20.200	781	-10.00
EMC	25.500	1,000	40.350	1,582	21.62
GLW	16.127	1,000	20.940	1,298	11.78
GSTRF	18.063	1,000	0.590	1,000	-76.76
GX	23.281	1,000	15.600	670	-15.70
JDSU	8.797	1,000	21.190	2,409	45.50
MUSE	6.313	1,000	46.450	7,358	134.26
NT	13.838	1,000	14.450	1,044	1.86
QCOM	7.266	1,000	65.379	8,998	155.26
RFMD	8.563	1,000	34.030	3,974	80.14
XLNX	19.281	1,000	45.310	2,350	43.97
TOTAL		14,000		42,288	**60.24**

Oh my gosh!!!! 45.5% was an **understatement**! The WORRY FREE portfolio actually made **OVER 60%.**

I need air! I can't believe this!

Facts speak for themselves but the enemies of truth try to distort facts to suit their convenience. What are the enemies of LTBH saying? That a short term phenomenon, a bubble that burst, a happening to which we can assign a duration of maybe 12 to 18 months, is enough to discredit a technique that has worked over the years and which you would need adverse long term data to dispute. But here I am presenting short term data that straddles the bubble event and which proves that the bubble was just a flea on an elephant's back.

Who seems to be a principal champion of trading and short selling? One of the unfortunates who got caught in the euphoria of the bubble. He made the mistake of entering the market at the top of the bubble. Now he is mistaking is "recovery" for a mighty stock market strategy. I'm afraid that he is just compounding his errors. He can't see the forest for the trees.

It is not enough to have a look at the numbers, you need a rational explanation of why these numbers come up. I find that the explanation is rather simple. The stock market, in the long run, reflects the economy, more specifically, it reflects human economic progress. If the market is growing historically at a 12 to 15% rate, then the underlying companies' worth must be growing at that rate. But the market is a hodgepodge of all sorts of businesses and industries. Some are growing, some are shrinking, some grow with population, some are just passing fads. If you could somehow screen out the fast growers for your portfolio, then your portfolio should outperform the market. This, of course, is the holy grail of all investors (here I omit traders whose holy grail is to detect short term market inefficiencies to exploit). If with the help of the GTR or The Gorilla Game we can spot these fast growers, then we should buy these companies early and hold them to maturity, until the time they cease to be fast growers. A look at any stock price chart should convince you that prices fluctuate wildly and picking the tops and the bottoms is very difficult. Should you by mistake buy at a top, it is going to be very difficult to recover your loses. So timing is not only difficult but dangerous. On the other hand, using a logical approach like the one used by Gilder or by Moore, you should be able to spot enough winners to crate a very successful portfolio. And the above WORRY FREE portfolio table shows how the mother of all bubbles does not really affect it very much at all. On the other hand, if your timing was bad and you bought at the top.... It is fairly easy to avoid buying at the top, just do your buying using dollar cost averaging over a period of several months.

Let me repeat what I recently learned from playing with some trading models:

1.- The most money is made by accumulating a large number of shares. If you just trade in and out of positions you never make BIG money.

2.- Selling is contrary to the first objective. You cannot accumulate shares if you keep on selling them. Selling short is even worse than selling down to zero shares.

3.- If you have a fixed amount of capital, if all you do is to buy, then you will limit the number of shares you can accumulate because once your cash runs out you can buy no more. The way to get around this difficulty is to do some trading. You need to discover the inefficiencies of the market that allow you to sell high and buy low. Since this is very difficult to do you will not have a consistent record. This is the reason why you never sell the whole position because you might pick a very poor point in time to do so. On the other hand, if you buy and sell small quantities of stock as compared to your investment capital, you can afford to make mistakes if your overall success rate is better than 50%.

I am reminded of Gary Winnick's strategy for Global Crossing: build a zero cost network by selling small parts of it for the cost of building the whole thing. As stock prices spike up, sell part of your holdings so that what remains is at zero cost. How can you lose money that way?

I don't think that the stock market is a zero sum game. I don't believe that what one investor loses winds up in someone else's pocket. The market expands and shrinks growing and depleting portfolios. Poor players will manage to lose money. Smart players will manage to make money. But in the long run the stock market will reflect the underlying value of the commerce and the industry sustaining the nation and the world. Short term players -- short sellers -- have an interest in temporarily depressing a stock's price so that they can increment their meager winnings. LTBH players could care less about price swings except to use for their short term trading needs as described above. This is the reason why I have no economic desire to "bring" people over to "my cause." Shorts increase liquidity and short term market distortions which helps anyone who wants to take advantage of these market happenings. The only ones who lose are the ones who, convinced by the shorts, sell at the wrong time, at the bottom -- caveat emptor.

But what does bother me is that some people twist my words around for their own purposes. I hope I have made it very clear to them that this will not be tolerated. They will be rebutted!

Denny
"Demand creates queues. Supply gets rid of them."

Software Times