Notes for the Washington Convergence - October 7, 2000

Investing styles

Sandy: Thank you for organizing the Washington Convergence which gave me the opportunity to meets a lot of my fellow GTF members and to meet Richard and George Gilder.

>>>and an investing topic moderated by Denny Schlesinger (Denny)

Since we don't have external input at this meet, I will present a short piece on investing styles to prime the audience for a discussion. I would like to invite Woody, XXX and YYY to come to the podium to be part of the panel.

There are probably as many investing styles as there are investors and I believe diversity is good, mainly because it creates liquidity, the sine qua non of the market. If we all used the same style, the same investment criteria, we would all be buyers or sellers at the same time, liquidity would dry up and volatility would go to infinity. The Gilder Effect is proof of this -- too many people chasing the same stock at the same time.

Raise hands:

- Speculators
- LTBH
- Traders
- Modern Portfolio Theory

Based on the above, I don't want to convert you all to my investing style as it would ruin it for me if you did! But I do want to talk about it as the starting point for the discussion I hope will result.

What is the purpose of The Market?

The corporate view:
In theory, at least, the market is supposed to raise money for industry. If you look at 99% of the activities of the market, the daily trading, me selling to you

and you selling to someone else, it is difficult to see how the market accomplishes its task of providing funds for enterprise. IPOs clearly do funnel funds to enterprise. But what about all the subsequent trading of those initial shares. Even though no money flows to the companies, information does. The owners are telling management "You are doing well," or "You are screwing up." As the stock price goes up and companies use their treasury shares to buy other companies, newly created wealth (or at least newly created money) is put to practical use. Management has also discovered that stock options work better than salaries and bonuses as a reward for useful employees. Again, the newly created money is used as compensation reducing the traditional "cost of production" and passing it directly to the shareholders as dilution of their share of the company.

The individual view;

In this last quarter of the century we have come to view the market as a safe place to put our money. This was not always the case. When my mother died she left me what she had considered for several decades her safety net: mostly gold coins and jewelry. Some of it represented family tradition like grandma's brooches and wedding and engagement rings but most of it was old, out of style jewels. Since times change, some of this I gave to my family and most I converted into company shares.

There are two ways of looking at all the loot one has placed in the stock market: as an investment in companies or as a stake in a gambling casino. I am not being pejorative when I call the market a gambling casino, I'm trying to illustrate the two principal ways of thinking about the market: as a way to invest in the productive factors of your country or as a giant gambling game. In the old days, at the turn of the century, the stock market gamblers called themselves stock operators or speculators and they warned against placing money in "investments" in the market. If they wanted to invest, they would buy annuities. In the stock market they "swung a line" based on a "stake" that was engorged by 90% margin.

The stock operators clearly understood "vigorish" -- the advantage in betting odds that a bookmaker or gambler creates to produce profit. When the market or a particular stock was going up, money is flowing into the market and it pays to bet long or bull. When the market or a particular stock is going down, money is flowing out of the market and it pays to bet short or bear. This is the logic behind the maxim: "Don't fight the tape." Play that side of the market that has vigorish on its side. Stock operators had to be able to "read the tape" something that they applied to stocks and commodities and had to understand the world and market conditions which they applied mainly to commodities (as opposed to stocks). The modern day descendants of the stock operators are the day traders and the technical analysts.

The great and lasting fortunes of the turn of the century were not made in the stock market, they were made in industry by the so called "robber barons." Bill Gates, Scott McNealy and Larry Ellison are some our modern day "robber barons" and they have made more money than just about anyone in the stock market. This is just about enough to convince me that investing is better business than gambling, sorry, trading in the stock market.

I see three ways of investing in the market. If you don't really want to get involved and you want to match the market, you buy one or more index funds and you are done with it. Buying the rest of the funds, specially the load ones, does not make sense to me because they, on average, don't outperform the market and they cost money. Rather than investing in a fund, if you want to make it a no-brainer, subscribe to a reputable stock picking newsletter with good track record like Louis Navellier's MPT Review and follow it to the letter. You'll do pretty good and most likely, you'll beat the market.

The other two ways require active and informed involvement in the market. (Here is where I was going to write about Long Term Buy and Hold but I ran out of time or energy or something ;-)))))

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