December 31, 2001

Reasonable Expectations.

This is the time of year to make New Year's resolutions. Mine is to go back to expecting reasonable returns on my portfolio. Reasonable returns are beating the market by maybe a point or two. Why is this reasonable? Because if I don't expect to beat the market I might as well just buy index funds and that will return the market average at the lowest transaction cost available.

What follows I believe is valid for a portfolio heavily biased towards technology or for the technology part of a portfolio. I don't think that Warren Buffett needs to follow my advice! :-))

Over the years I developed a fairly conservative investing strategy. I split my portfolio into 50 to 70% in stocks and 30 to 50% in bonds or dividend yielding preferred shares which are very similar to bonds. In stocks I bought mostly companies whose business I understood, businesses that were firmly established. Since I come from the computer field, my portfolio was usually heavily biased towards technology stocks. During those times when I didn't have a clue, I would just follow one of Louis Navellier's moderately aggressive portfolios. As for the bonds, in times of high rates I would buy medium term [4-5 years] bonds and hold them to maturity. BTW, make sure your bonds are not callable -- they will call them just as the bonds are getting interesting :-)).

As I look back to those pre GTR days, I did not have a LTBH strategy after all. Although I was not a frequent trader, I was an opportunistic trader. If there were profits to be taken, I would take some money off the table. If there were losses, I would exit the stock. One of the reasons that I did not take enough profits during the GTR boom is that taking profits also means leaving a lot of profits on the table. Of course, the risk in not taking them is that they can disappear as if by magic :-((. Reasonable expectations dictates that you should take some profits even if that means leaving some on the table.

If you invest in brand name commodities like Coca Cola and Gillette, LTBH is certainly a good strategy because people will continue to drink sugar water and to groom themselves, preferably with brand name products that they have learned to trust. Is LTBH appropriate for a technology biased portfolio? If you believe the Gorilla Game, and I do, then gorillas are perfect candidates for LTBH. But make sure you buy the gorilla only after it has established itself as a gorilla. The problem is that there are very few gorillas out there and that there are many non gorillas which produce better returns than gorillas do. As far as I can tell, the only two Telecosmic gorillas out there are Qualcomm and ARM Holdings. The non gorillas, specially the chip makers, tend to be cyclical so they are not really good LTBH candidates. You can do better with opportunistic trading in these stocks -- buy at the start of a cycle and take profits as they arrive.

Reasonable expectations and GP marketing

Grow Rich on the Coming Technology Revolution is not a reasonalbe expectation for someone who is just investing in stocks. The people who will grow rich on this revolution are the people who are making it happen, the kids in the garage, and the people who can mass market products to those wishing to grow rich. This second class includes publishers and investment bankers.

Make Back the Money you Lost on Gilder is also not a reasonable expectation. What you had some time in the past is totally irrelevant for the future. The only things that are relevant today are your current financial situation and you goals. By all means, set goals, achievable goals, but don't base them on a past that will not return.

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