

October 10, 2008

One of our clients called, saying he had a question: "I'm just curious as to what you are doing to insure that I won't lose a lifetime of savings?" I could hear in his voice that he really wanted to know and to be reassured. I'm going to take a cue from my old high school algebra teacher and assume that if someone in the class asks a question, chances are that other folks in the room are wondering the same thing. We want to make sure we hear your concerns and are available to answer your questions.

So, what *are* we doing? Well, first we do exactly what Warren Buffett does: we remember Mr. Market.

In 1987, a month after TIME printed the cover to the right, Buffett recounted the story of Mr. Market in Berkshire Hathaway's [letter to shareholders](#) and it stands to be one of the most valuable 'gifts' he ever gave fellow investors. He told it just as it had been given to him 37 years before by Benjamin Graham, his teacher at Columbia Business School. I'd almost feel guilty filling up so many pages of our commentary with another man's words, except these paragraphs have enough weight and meaning to alter the course of many generations (the emphasis in the following is mine):



Ben Graham, my friend and teacher, long ago described the **mental attitude toward market fluctuations that I believe to be most conducive to investment success**. He said that you should imagine market quotations as coming from a remarkably accommodating fellow named Mr. Market who is your partner in a private business. **Without fail, Mr. Market appears daily and names a price at which he will either buy your interest or sell you his.**

Even though the business that the two of you own may have economic characteristics that are stable, Mr. Market's quotations will be anything but. For, sad to say, **the poor fellow has incurable emotional problems**. At times he feels euphoric and can see only the favorable factors affecting the business. When in that mood, he names a very high buy-sell price because he fears that you will snap up his interest and rob him of imminent gains. **At other times he is depressed and can see nothing but trouble ahead for both the business and the world. On these occasions he will name a very low price, since he is terrified that you will unload your interest on him . . .**

. . . But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice: **Mr. Market is there to serve you, not to guide you**. It is his pocketbook, not his wisdom, that you will find useful. If he shows up some day in a particularly foolish mood, you are free to either ignore him or to take advantage of him, **but it will be disastrous if you fall under his influence . . .**

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. . . In my opinion, investment success will not be produced by arcane formulae, computer programs or signals flashed by the price behavior of stocks and markets. **Rather an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace.** In my own efforts to stay insulated, I have found it highly useful to keep Ben's Mr. Market concept firmly in mind.

Following Ben's teachings, Charlie [Munger] and I let our marketable equities tell us by their operating results - not by their daily, or even yearly, price quotations - whether our investments are successful. The market may ignore business success for a while, but eventually will confirm it. **As Ben said: "In the short run, the market is a voting machine but in the long run it is a weighing machine."** The speed at which a business's success is recognized, furthermore, is not that important as long as the company's intrinsic value is increasing at a satisfactory rate. In fact, delayed recognition can be an advantage: It may give us the chance to buy more of a good thing at a bargain price.

Graham first told this story in 1934. You might think this seems out of date and not applicable to today's fast-paced and sophisticated markets - you'd be wrong. It was precisely the same market volatility then that's causing investors to feel incredibly unsettled now, only that it was more rampant then than it is even now. During the two years before Ben Graham 'invented' Mr. Market, he experienced (in retrospect) 35 of the 100 worst days in the stock market's history. You and I, on the other hand, over the last six years have only experienced 4 of the 100 worst days (all of them in the last month.) His words have never been more true.

So, now that we know that this "poor fellow" Mr. Market has "incurable emotional problems," how can his story help us? What can we do about it? Next, we need to gain some perspective.

Just as, in the cold of winter when your fingers are numb and your ears hurt after being outside five minutes, you can't imagine ever being warm again, sure enough, come August you'll have to crank up the A/C as usual. Or after Thanksgiving dinner, as you sit down to watch some football, you can't fathom ever eating again, but there you are at halftime, slapping mayonnaise on a cold turkey sandwich. After all that has happened over the last 18 months, it's hard to find someone who thinks the US (or the World for that matter) will *ever* recover, that home prices will *ever* rise or that their portfolios will *ever* add another dollar . . . we beg to differ.

In America, over the last 80 years, we've seen some of the worst of human history: Depression, Recession (12 total), WWII, Korea, Vietnam, one Presidential assassination, the Cold War, one Presidential resignation, one Presidential impeachment, the World Trade Center attacks, and now an unprecedented Credit Crisis. However, during this time the Dow marched from a price of 106 on October 10, 1931 to a price of 8,462 today. Wow. If the worst of human history produced this, it makes you wonder what a good 80 years would produce, doesn't it?

We believe the markets have completely lost their way. It sure feels like it when you watch the evening news (or see the newest cover of TIME, right): runs on banks, government bailouts, congressional hearings, failed investment banks, record stock market declines, record oil and gas declines, money market funds 'breaking the buck', bans on short selling, and increases in unemployment.

US banks right now are sitting on their collective hands, choking off the flow of credit and slowing the economy. But, will this always be the case? We don't believe so. These are troubling economic times for sure, our very way of life feels threatened. But, we don't believe the American Story is over, not by a long shot. Every economic recovery since World War II has been preceded by a stock market rally, and these rallies always start when conditions are grim. Today, conditions are grim.



So, after remembering Mr. Market and gaining some perspective, we're left with only one option: start looking for opportunities. On many measures, we believe that stocks are cheap (though they can get cheaper). There are businesses today that are selling for 35 cents on the dollar, those are real opportunities. In two or three weeks they might be selling for 20 cents on the dollar, but in three or four years we don't believe that will be the case.

Our plan of action has not altered; we focus on each business, one by one. We pay attention to the price we pay for a business. We evaluate a business as a stand alone entity rather than on what price someone else is willing to pay for it tomorrow. We try to stay rational in a very irrational marketplace. These actions, drawn forth faithfully and ceaselessly, will produce sustainable wealth for our clients.

While we believe this is the rational view, it has been a tough year to be a long term investor. As Legg Mason fund manager Bill Miller recently said, "Most of us value investors think we have had plenty enough bargains already, and may not be able to handle that many more." We're sure you feel the same way. We believe at some point the markets will surprise us in the opposite direction. Until then, here's to hoping we've found enough bargains to last us a while.

We continue to believe that we will pull out of this difficult situation. We've done it every time in our history. If you believe that America is still open for business, if you believe in hard work, ingenuity, and innovation, then join us in fully embracing the long-term view.