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Investment Strategy
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Investment Strategy

"Rich Man, Poor Man!"

After 43 years in this business I have seen a number of cycles, and developed a long-term perspective, much like Richard Russell wrote about in "Rich Man, Poor Man." I like this story:

> In the investment world wealthy investors have one major advantage over the little guy, the stock market amateur and the neophyte speculator. The advantage wealthy investors possess is they DON'T NEED THE MARKETS. I can't begin to tell you what a huge difference that makes, both in one's mental attitude and in the actual handling of one's account. The wealthy investor doesn't need the market because he already has all the income he needs. He has money coming in via bonds, T-bills, money market funds, real estate, and stocks. In other words, the wealthy investor never feels pressured to 'make money' in the market.
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> The wealthy investor tends to be an expert on values. When bonds are cheap and bond yields are irresistibly high, he buys bonds. When stocks are on the bargain table and stock yields are attractive, he buys stocks. When real estate is a great value, he buys real estate. When great art or fine jewelry is on the 'giveaway table,' he buys them. In other words, the wealthy investor puts his money where the values are. And if there are no outstanding values, the wealthy investor waits. He can afford to wait. He has money coming in daily, weekly, monthly. In other words, he doesn't need the market. He knows what he is looking for, and he doesn't mind waiting weeks, months or years (they call it patience).
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> What about the little guy? This fellow always feels pressured to 'make money', to 'force the market to do something for him.' When this fellow isn't buying stocks at 3% yields, he's off to Vegas or Atlantic City trying to win at craps or he's spending ten bucks a week on lottery tickets or he's 'investing' in some crackpot real estate scheme with an outfit that his bowling buddy told him about. And because the little guy is forcing the market to do something for him, he's a consistent and constant loser. The little guy doesn't understand values so he always overpays. He loves to gamble, so he always has the odds against him. He doesn't understand compounding and he doesn't understand money. He's the typical American and he's perpetually in debt.
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> The little guy is in hock and he's always sweating, sweating to make payments on his house, his refrigerator, his car or his lawnmower. He's impatient, and he constantly feels pressured. He tells himself he has to make money fast. And he dreams of 'big bucks'. In the end the little guy wastes his money on the market, he loses his money on gambling, and he dribbles it away on senseless schemes. In brief, this 'money-nerd' spends his life running up the down-escalator. Now here's the ironic part of it. If, from the beginning, the little guy had adopted a strict policy of never spending more than his income, if he had taken that extra income and compounded it in safe, income-producing securities – in due time he'd have money coming in daily, weekly, and monthly – just like the rich guy. Then in due time he'd start acting and thinking like the rich guy. In short, the little guy would become a financial winner instead of a loser.

After more than 50 years of writing "Dow Theory Letters," Richard Russell says the most popular piece he's ever published is the above "Rich Man, Poor Man" essay. In this day and age of constant advertisements, infomercials, junk mail, harassing cold calls haranguing all about how to make a killing in the stock market, real estate, commodities, etc. etc., etc., it's refreshing to read some advice from an honest old pro that makes sense. Moreover, almost every magazine you see tells you what mutual fund you should buy, how to invest to retire, how you can make it big in whatever. Indeed, we would bet that those writers, advisors, and testimonial seers who concoct those pieces make more money selling their "pitch" than following their own advice. Putting that pitch on paper or through the TV, radio, or phone is a lot easier than actually putting up their own money. I know many stock brokers, advisors, writers, etc. who never invest themselves. Yet they make their money telling others how to do it. A case in point is a story in a widely read financial magazine. It chronicles a now successful promoter, who earlier tried the get-rich-quick schemes, which didn't work for him. So that led him to "why not trade commodities and get rich," which again did not work for him; and then later, "why not write a book about how to trade commodities and get rich." To make a long story short, he made mucho moola selling the book!

Please read domestic and foreign disclosure/risk information beginning on page 3 and Analyst Certification on page 3.

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STOP HERE NOW, and go back and read RICH MAN, POOR MAN again!

In the world we live in, few look at risk. Most only look at reward. The few who do look at risk (the educated, the street savvy) make their money at the expense of the great unwashed majority who swallow the noise nonsense about getting rich quick. Investing is a get rich slowly process. You have to put your money at risk in the face of uncertainty. Emotions run rampant before the uncertainty of floating, fluctuating, often violent and volatile markets. Constantly discounting prices are fickle and full of surprises. Disorder is usually the norm. Importantly, remember when you do invest, and put your money at risk, you are using “after-tax” dollars. The Federal, state, and local governments along with sales taxes are confiscating more and more. While the POOR MAN pays fewer taxes, the RICH MAN pays much more when you take into account the top bracket rate including the surtax, the Medicare payroll tax, the work-sheet phasing out of deductions and exemptions, etc. Therefore, when you consider straying away from a compounding type of investment make sure you understand risk and that you get value and a margin-of-safety price concession. Maybe John Burr Williams, a pioneer in the concepts of modern portfolio theory, said it best, “The value of any stock, bond or business is determined by the cash inflows and outflows, discounted at an appropriate interest rate, which can be expected to occur during the remaining life of the asset.” Oh, and by the way, if you doubt the magic of compounding, consider this little ditty from Andrew Tobias:

> There was the king who held a chess tournament among the peasants and asked the winner what he wanted as his prize. The peasant, in apparent humility, asked only that a kernel of wheat be placed for him on the first square of his chessboard, two kernels on the second, four on the third and so forth. The king fell for it and had to import grain from Argentina for the next 700 years. Eighteen and a half million trillion kernels, or enough, if each kernel is a quarter-inch long (which may not be; I’ve never seen wheat in its pre-English-muffin form), to stretch to the sun and back 391,320 times.

That was nothing more than one kernel compounding at a 100 percent square for 64 squares. Accordingly, remember the old adage, “He who understands interest – earns it, he who does not understand interest – pays it.”

The call for this week: Last week was a pretty wild week starting out with Monday’s 90% Downside Day where 90% of total Up/Down Volume, and total Up/Down Points traded, were recorded on the downside (read: negative), leaving the S&P 500 (SPX/1797.02) down ~41 points. It was the second 90% Downside Day in the past two weeks with the first occurring on January 24th, which broke the SPX below its first support zone of 1808 – 1813, thus now that level becomes an overhead resistance level. The selling continued into Tuesday morning, but then stocks stabilized and rallied. Accordingly I thought we would see a decent “follow through” rally on Wednesday, yet that just didn’t happen. Come Thursday and rumors are swirling that Friday’s non-farm payroll number would be 300,000, with a concurrent “print” of a 6.5% unemployment rate, which prompted stocks to soar as short-sellers bought to cover their short-sales. When Friday’s numbers disappointed, the “Street” reasoned that the Fed would curtail its “tapering” program and stocks again rallied. It kind of reminded me of Roberto Clemente, “Good pitch, bad pitch, it no matter . . . I hit them all!” The same seemed to apply to the equity markets in that, “Good number, bad number, it no matter!!” Granted, the early week wilt had left the McClellan Oscillator very oversold, so some kind of bounce was due, but as of now it looks merely like a short-covering affair that is unlikely to travel above the overhead resistance zone of 1808 – 1813.

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