INVESTOR'S DIGEST
INVESTING 101
EXPANDING YOUR INVESTMENT KNOWLEDGE

Short-term expectations rarely yield long-term results

If the investment 'pros' are pressured to perform over the short term, they'll likely fall victim to a market that's seldom rational, Sean Seah will tell you

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The old man, who'd been fishing next to Sean and who'd been watching him, finally spoke.

"Hey, sonny. The fish won't fall into your bucket. You've got to go out there and get them!"

"Huh. What?" said Sean who seemed to have been in a trance.

"I'm saying you can't make the fish come to you just by staring into the sea," the old man explained. "You need to go out there and get them, like this!"

The old man laughed as he tugged at his fishing rod. At the end of the line, a fish he'd skilfully caught surfaced from the waters. He then smoothly pulled the catch towards him and, with one single movement, placed it in his bucket.

Sean was impressed. "Wow! You're a good fisherman, sir!"

"Well, thank you, sonny. It all begins by casting the bait into the sea," the old man replied.

"What do you mean, sir? Of course, you'll need to cast the bait in order to catch the fish."

"That's right, sonny," the old man said. "You looked troubled just a moment ago. And the solution to your troubles won't come to you unless you go out and cast your bait in.

"In other words, you have to go and do something about it. Worrying seldom gives you the solution."

The old man grinned as he took a bite from his burger, which was probably his breakfast.

Sean soon found himself sitting beside the old gentleman, sharing what he'd experienced.

"And before I knew it, I had lost huge amounts of money and I . . ." Sean tried to complete his sentence, but felt himself choking back tears.

"And you infringed investment rule no. 1!" the old man said.

"Investment rule no. 1? What's that?" Sean asked as he regained his composure. The old man's quip jolted them both out of the brooding atmosphere.

"There are two very important rules in investing. If you stick to them, you'll be successful. But if you infringe them too many times, you're sure to end up poor.

"Investment rule no. 1 is never to lose money. Investment rule no. two is never to forget rule no. 1."

"What?" Sean exclaimed. "These are the most important rules? Never to lose money?"

The old man sensed Sean's disappointment, but wasn't surprised. He ignored Sean's startled remarks and continued.

"When you break investment rule no. 1, you must understand the damage you've just incurred.

"Let me ask you this. If you lose 50 per cent of your initial money, how much return must your remaining money make in order to recover your losses?"

"If I lose 50 per cent, I'll need to make 50 per cent back," Sean replied without much thought.

The old man reflected for a moment and then responded.

"Most people go into the stock market aiming to make a lot of money. But they aren't aware of how damaging losing money is.

"Let's factor in some real figures. If you started with $100,000 and you lose 50 per cent, how much are you left with?"

"Well, if I lose 50 per cent of $100,000, I'm left with $50,000," Sean quickly replied.

Gone Fishing with Buffett

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But Sean wasn't really interested in learning why he shouldn't lose money. He wanted to know how to make his losses back. He wasn't interested in being reminded of the 'damage' he'd incurred.

"And for your $50,000 to grow to $100,000, how much return must it make?" the old man asked.

"Fifty thousand to $100,000; isn't it 50 per cent?" Sean asked.

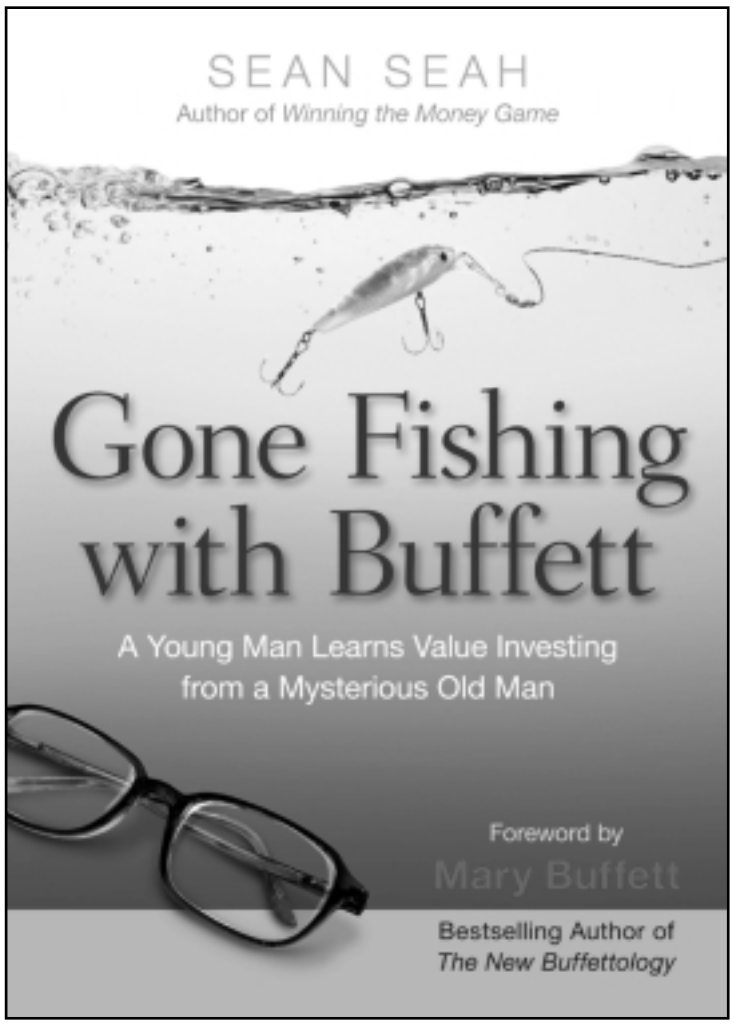
"Hey, wait!" Sean exclaimed. "It's 100 per cent! So, I need to make my money work doubly hard to make back what I've lost!"

The old man smiled. "And that's one of the main reasons why, when I choose to invest my money, I only invest when I know I won't infringe rule no. 1."

"But how can we not lose money when we invest?" Sean asked. "In order to have some returns, we need to take risks, don't we?"

The old man thought for a moment before speaking.

"Sonny, most people think that in order to invest in the stock market, you need to take on a lot of risk. But let me put it to you this way: risk comes from ignorance."



Sean stared at the old man and the old man looked straight back. Sean was amazed. A few minutes ago, this old man had appeared so insignificant, fishing at the jetty.

But all of a sudden, he seemed so wise and had so much to teach.

"Can you explain it more precisely?" Sean asked.

"Sure. You see, risk is contextual. If I were to challenge you to climb Mount Everest today, would you do it?" the old man asked.

"That wouldn't be feasible. It's too risky!" Sean replied.

"You're right, neither would I," the old man said. "But what if I offered you a million dollars; would you then do it?"

"A million dollars! That's attractive," Sean said. "But to be honest, I don't think I'd make it alive."

"Good, but what if I extended it to a year? Would you then take up the challenge?"

"One year? One million? I'd definitely take up the challenge!" Sean replied.

The old man paused for a moment before responding.

"Interesting. Didn't you mention a moment ago that it was too risky? What difference does it make if I give you an additional year?"

Training would start

"Well," Sean said, "if you give me one year, I'd go and learn from the best coaches, start training, get the best equipment and so on."

The old man stroked his chin reflectively. "Well, well, so after you go through all that, isn't it still risky to climb Mount Everest?"

"The risk would probably still be there," said Sean, "but it would have decreased significantly because I would be more prepared."

"So, am I right to say that for someone who doesn't know how to climb mountains, climbing is risky? the old man asked.

"But for a well-trained, well-prepared professional," he continued, "is the risk much lower because they know what they're doing?"

"Ah, I get the point now," Sean nodded. He then paused for a moment as if he were missing something and then he remembered.

"But sir, I understand from my research that most professionals can't consistently beat the market.

So, as well prepared as they may be," Sean continued, "investing is still risky for them, isn't it? Otherwise, they should have been beating the market."

The old man chuckled. "You're right; most so-called professionals can't beat the market. Yet the market is the only place where people who drive BMWs take advice from people who take the train."

"But these people are pros, aren't they?" Sean asked plaintively. "Shouldn't they know what they're doing?"

"Sonny, they know what they should do. Unfortunately, they're not able to do so,"the old man replied.

"You're getting me all confused here." Sean said.

"Well, you see, investing is simple. What we do is buy businesses with good and exceptional economics — and at sensible prices.

"This is all I do. And then I wait for the market to realize the value of the business and price them up."

"Buy businesses? At sensible prices?" Sean asked incredulously. "Do you mean looking at a stock's fundamentals?

"I've attended courses where I was told to ignore fundamentals. And these were pros who made millions in the stock market."

"These are the people I'm talking about," the old man said.

"They know which businesses to buy and they even know at what prices to buy them.

"But instead, they have a very short-term perspective. So they try to predict market movements and make a killing. Well, so far, how's that been working out for you?"

"Not very good, sir." Sean replied. "As I mentioned earlier, I've broken investment rule no. 1 big time. losing lots of money.

"So why don't the professionals do as you say — buy good businesses at sensible prices? Why do they try to predict the market instead?"

"Well," said the old man, "most of these so-called pros are pressured to perform in the short run.

"But in the short run," he continued, "the market is irrational. It prices the businesses based on both news and speculation.

"Sometimes, a company's stock price dips just because of rumours that the chief executive officer has health problems.

"And the price may rise when an analyst writes something great about the business.

Prices will swing

"The fact is, these rumours don't make a business good or bad, but the price of the stock swings uncontrollably like wildfire.

"In the short run, this is common. In fact, it's good; otherwise, there wouldn't be many chances for investors like me to buy good businesses at a discount."

Sean thought for a moment and then spoke.

"But don't you want to make money in the short run?"

"I definitely want to make money," the old man said. "I buy businesses with the assumption that the market may close for the next five years.

"In the long run, the market is a weighing machine. Sooner or later it realizes the actual value of a business and adjusts the price to reflect how much it's worth."

"Wow, does that always work?" Sean was impressed with what the old man had shared.

But he was also doubtful and wary about advice from the pros. After all, he'd lost money after attending courses taught by experts.

"I can only say this," the old man continued. "The market changes from time to time, but investing principles never change.

"Buy good and exceptional businesses at sensible prices. Repeat until you're rich."

Sean paused and visualized how he would, from now on, choose businesses which are good to exceptional, while continuing to buy them at sensible prices.

But what exactly constitutes a good business? And what did the old man mean when he said 'sensible prices'?"

Sean needed to know the answers as they seemed to provide the only hope for him to recover his . . . losses.