

“It’s Different This Time”

I’ve been hearing these four words more frequently as of late. “The fundamental rules of investing have changed.” I’ve been hearing that one a lot too. “The old methods don’t apply to the New Economy”. Ditto.

Let me assure you that it is not different this time, nor have the rules changed, and the methods have not changed. Throughout the history of investing, one of the most dangerous statements has always been “it’s different this time.” It is particularly dangerous in that the more ubiquitous that phrase, the closer we are to a jolting reminder that it is NOT different this time, nor will it ever be. Investors who buy stocks are buying a share of the future profit of a company. If the company never earns a profit the stock is worth zero. This will not change.

At the top of every market cycle, investor confidence booms. At the bottom of every cycle, investors become ultra-conservative. This too, apparently, does not change. I see many people who have emerged from the conservative gloom cast by the Asian Crisis and the Russian Debt Crisis – they were too fearful to invest at the market’s bottom, but they are confident and aggressive now, quite some distance from the bottom. With little regard for valuations and diversification, investors now confidently chase the returns of a few red-hot stocks. Japanese returns were red-hot in 1989, but the Nikkei stood at 40% of its peak value a decade later. Asian returns were red-hot until 1997. Bre-X was red-hot until...well, you get the picture. The collective investor memory is shockingly short.

Has technology brought on a New Economy and rendered obsolete the old notions of sound investing? No. There have been many technological revolutions in the past and not only have they not changed the rules of sound investing, they haven’t even made for good investments. The examples are plentiful; here are two:

“There appears to have been at least 2000 car makers [at the turn of the century] in an industry that had an incredible impact on people’s lives. If you had foreseen in the early days of cars how this industry would develop, you would have said, “Here is the road to riches”. So what did we progress to by the 1990s? After corporate carnage that never let up, we came down to three U.S. car companies – themselves no lollapaloozas for Investors. So here is an industry that had an enormous impact on America and also an enormous impact, though not the anticipated one, on Investors”. Warren Buffett, Fortune magazine, Nov. 22/99.

“For the computer industry, if you had put \$1 in every computer stock in 1980, over the next 20 years you would have compounded at 4% per year.” Mike Lee-Chin, AIC Funds, 1999 Annual Report.

Diversified portfolios have enjoyed above average returns of late due to their weightings in hot sectors. Diversified portfolios will also provide protection from the sharp corrections that always come to narrow sectors of the stock market. The rules haven’t changed. Our approach to investing should not either. I still remember some of the old rules and practice them to this day. Buy low (when others are conservative or fearful); sell high (when others brim with confidence or euphoria). Don’t put all your eggs in one basket – still a wise old rule of thumb. If it sounds too good to be true, it probably is. Nothing lasts forever.

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