



As We See It

"The bigger the herd, the greater the stampede."

Clark Gable
1941 Film—*Honky Tonk*

One of the most dangerous environments for investors is a speculative mania or bubble. Very simply, manias are speculative excesses. They often are associated with financial assets but can occur in surprising places.

One of the earliest recorded and best known manias was "tulipomania" which occurred in Holland in the early 1600's. The tulip was introduced into Holland early in that century and immediately became popular. The price of tulip bulbs rose to astronomical levels as more and more people speculated in them. Eventually, the more prudent began to see that this folly could not last forever and that somebody must lose in the end. As this conviction spread, prices collapsed and many speculators suffered financial ruin.

In a presentation on the psychology of investing at this year's Contrary Opinion Forum, psychiatrist John W. Schott, M.D. identified the following characteristics of a speculative mania or bubble.

- There has to be a believable concept that offers a revolutionary and unlimited path to riches.
 - There has to exist a surplus of funds along side a shortage of investment opportunities.
 - The idea has to be one that cannot be irrefutably disproved.
 - Once the mania gets under way the idea has to have sufficient power to spread from the minority to the majority as the crowd begins to imitate its leaders.
 - Price has to exceed traditional levels of over valuation.
 - There has to be a fear of missing out.
 - There is the appearance of a cult figure such as Samuel Insull and Jessie Livermore in the 1920's.
 - The bubble always lasts longer than anyone can imagine.
 - Fast easy gains lend credence to shady business practices.
 - The bubble never ends by slow decompression, but bursts and collapses.

These characteristics beg the question as to whether we are presently in a speculative mania for equities. Many of the characteristics identified by Dr. Schott typify the present equity market. For example, an ever growing percentage of the population have become participants, valuations are high and Warren Buffett might be considered the cult figure for this era.

On the other hand, skepticism and concern are plentiful. Many are bearish. These are not characteristics normally found at the peak of a mania.

One of the worst occupational hazards of the investment business arises out of our extraordinary ability to rationalize whatever is, and our common inability to foresee what will be. Having said that, it appears to us that the weight of the evidence suggests we have not reached the peak of a mania. We may have reached the peak of this market move from which a correction will occur, but a collapse a la that which follows a mania, while always possible, seems unlikely. Nevertheless, valuations are closer to the high side than the low side. It is a time to reduce expectations and to be vigilant and cautious.

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