



As We See It

"The question is not what you look at but what you see"
—Henry David Thoreau

One of the certainties of life is that the world in which we live, and the investment environment in which we operate, are in constant motion and flux. History has taught us that security valuation over time much resembles the swing of the pendulum mirroring the ebb and flow of investor psychology. In the present environment, investor psychology has been quite positive resulting in the Standard & Poor's 400 selling in excess of two times book value. Such a multiple is at the upper end of historic valuations. Moreover, during the last five years long-term bond yields and short-term rates have declined by one half and two thirds respectively.

Such a dramatic change in investor perception about inflation and a dramatic increase in the money supply which went to inflate financial assets as opposed to investment in productive assets. This change in investor perception has now become the conventional or consensus view and consensus views tend to result in extreme valuations in the securities market. It remains to be seen whether the present valuations are warranted.

During the current period of optimism, investor attention has been narrowly focused on positive factors such as the decline in inflation. All the while, some very real concerns linger. Should investor attention become directed toward the negatives, securities valuations could be in for a substantial adjustment.

We have been very cautious concerning the prospects for the financial markets. The major concerns which have resulted in our cautious attitude include: disinflation as a fading force; a less than positive impact from tax reform; the mushrooming budget deficit; the high debt levels of the consumer; a rapidly growing money supply and the threat of inflation reemerging.

Greed and impatience drive the crowd or majority and are enemies of successful investors. We think this is one of those times when one should be very cautious in making commitments to securities—especially those which are so popular and whose intrinsic values are so generally recognized.

We believe the key ingredient to a successful long-term investment program is a philosophy of winning by not losing. Therefore, we emphasize a conservative, contrarian, and disciplined investment approach. To win, one must at critical times do the opposite of what seems to be the sensible thing that everyone else is doing. Hence, except for selected situations, we are prone to accumulate cash and await opportunities to invest at more attractive levels.

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